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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and
R. FOSTER WINANS,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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QUESTIONS PRESENTED

1. Does SEC Rule 10b–5 impose criminal sanctions on a newspaper columnist for "misappropriating" his newspaper's publication schedule as part of a scheme to trade certain securities, where the newspaper is the only alleged victim of fraud and has no interest in the securities traded?

2. Should this Court reject the expansion of the mail and wire fraud statutes to cover breaches of purely private work-rules, intangible injuries, and incidental mailings and wirings?

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NO. 86–

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,

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UNITED STATES OF AMERICA,

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Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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Petitioners respectfully request that writ of certiorari be issued to review a decision of the United States Court of Appeals for the Second Circuit, entered on May 27, 1986, which affirmed (by a divided vote) petitioners' convictions of securities fraud, mail and wire fraud, and conspiracy, in connection with their "misappropriation" of the Wall Street Journal's publication schedule.

OPINIONS BELOW

The opinion (per Pierce, J., and Mansfield, J.) and dissenting opinion (per Miner, J.) of the Court of Appeals are reported as *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), and are reprinted in the Appendix to this petition, *infra*, at 1a–29a.[1] The decision of the United States District Court for

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1. Citations to the Appendix to this petition are denoted by a lower-case "a" following the page number ("___a"). Citations to the appendix submitted to the Court of Appeals are denoted as "A___"; citations to the transcript of proceedings in the district court as "T.___"; and citations to trial exhibits as "Exh. ___."

the Southern District of New York, reported as *United States v. Winans*, 612 F. Supp. 827 (S.D.N.Y. 1985) (Stewart, J.), is reprinted in the Appendix to this petition, *infra*, at 33a–73a.

JURISDICTION

The decision of the United States Court of Appeals for the Second Circuit, from which review is sought, was entered on May 27, 1986. With a minor exception,[2] that decision affirmed judgments of conviction that were entered on August 6, 1985 against petitioners in the United States District Court for the Southern District of New York, after a twenty–day non–jury trial before the Honorable Charles E. Stewart, Jr. Petitions for rehearing, with suggestions for rehearing en banc, were denied on July 17, 1986. This Court has jurisdiction to review the judgments of the Court of Appeals under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Title 18, United States Code

§ 371. Conspiracy to commit offense or to defraud United States

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

* * *

2. The Court of Appeals reversed the conviction of petitioner R. Foster Winans on certain counts which were based upon certain securities transactions between petitioner Kenneth P. Felis and a third party.

§ 1341. Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

* * *

§ 1343. Fraud by wire, radio, or television

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

Title 15, United States Code

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or

of the mails, or of any facility of any national securities exchange —

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 Code of Federal Regulation

§ 240.10b–5. Employment of manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This case presents the Court with the opportunity to resolve highly significant questions regarding the scope of the securities laws that were expressly left open by the Court's decision in *Chiarella v. United States*, 445 U.S. 222 (1980), and that divided the Court of Appeals in this case. Here, the Court of Appeals, in purported application of the unsettled

"misappropriation" theory of securities fraud, extended Securities and Exchange Commission ("SEC") Rule 10b–5 "beyond all reasonable bounds," 791 F.2d at 1037, 28a (Miner, J., dissenting), so as to redress not any alleged fraud on securities investors, but a potential injury to a newspaper's reputation.

This case also presents the Court with the opportunity to review the recent and much criticized "extraordinary expansion of the mail and wire fraud statutes"[3] and to resolve an apparent split among the circuits regarding the outer limits of that expansion. Here, the Court of Appeals, going beyond the limits set by some other circuits, approved the imposition of federal criminal penalties for an employee's infraction of his employer's private workrules, even though the rules had no analogue in public law or generally accepted industry standards, even though the sole harm allegedly caused by the infraction was to the employer's reputation, and even though the federal mailings and interstate wirings on which the charges were predicated bore no relation whatever to the infraction itself.

The facts of the case are set forth in detail in the specific findings of the district court, 612 F. Supp. at 829–38, 35a–50a, and are summarized by the Court of Appeals, 791 F.2d at 1026–27, 5a–7a. In essence, the case centers on the conduct of petitioner Winans from August 1982 through March 1984, when he was a reporter for the Wall Street Journal (the "Journal") and one of the writers of "Heard on the Street" ("Heard"), a daily market gossip column which focused on the movements and prospects of various stocks. The Heard column did not purport to give investment advice, and the Journal did not view or present the column as giving such advice to readers.[4] The Journal's wide readership and the column's popularity,

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3. *United States v. Weiss*, 752 F.2d 777, 791 (2d Cir.), *cert. denied*, 106 S. Ct. 308 (1985) (Newman, J., dissenting).

4. The Journal, a newspaper of general circulation, does not fall within the coverage of the Investment Advisors Act. *See* 15 U.S.C. § 80b–2(a)(11)(D). Neither the SEC nor any other regulatory agency has ever suggested the contrary (T. 50, 396–97).

however, tended to give the column a short-term impact upon the market price of stocks mentioned in the column.

Winans' columns never contained either corporate "inside" information or "hold-for-release" information given to the Journal for dissemination to the public at a subsequent time (T. 2459-60). The district court expressly found that "Winans was not a temporary insider [of the corporations he wrote about], did not owe any duty to the corporations he wrote about, and was not a tippee of any corporate inside information." 612 F. Supp. at 841, 56a. "In terms of the securities laws," the district court continued, "neither Winans nor the Wall Street Journal owed any duties at all to the corporations that were the subject of *Heard* columns or to the shareholders of those corporations." *Id.*

"Sources" who gave information to Winans for his column were free to trade at any time upon the information or the prospect of its publication in the Journal — and did so (T. 1881). Nevertheless, the courts below held that *Winans'* trading in securities on the basis of his knowledge of when Heard columns containing such information were scheduled to appear, and his prepublication disclosure of these schedules to others who also traded in the subject securities, constituted "securities fraud," solely because such use of the publication schedules was prohibited by the Journal's internal workrules regarding conflicts of interest. Specifically, a written conflicts of interest policy — contained at the back of a 40-page pamphlet given to new Journal employees — provided, among much else, that knowledge of forthcoming Journal articles was "deemed" to be the "property" of Dow Jones & Co., Inc. ("Dow Jones" — the owner of the Journal), that an employee could not buy or sell stocks if he was writing an article about the stock or knew of such an article by someone else which was to appear in the newspaper, and that an employee could not disclose the subjects of forthcoming articles to persons outside the newspaper.[5]

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5. Dow Jones never informed the Journal's readers of the existence of this internal policy until after the events of this case (Exh. WSJ-9; A110; T. 115-116, 159). In making that disclosure in a March 2, 1984 Journal

These rules were promulgated unilaterally by Dow Jones and were not contained in Dow Jones' collective bargaining agreement with Winans' union (Exh. WU–1, WU–2; T. 121; A100). Moreover, they were uniformly presented to employees as intended to go well beyond the requirements of the law, so as to avoid even a "misperception" of impropriety by outsiders (A112; T. 135–36, 231, 319, 1523). Nonetheless, it is the breach of these workrules that forms the lynchpin of the government's case here.[6]

In mid–October 1983, in violation of these rules, Winans agreed to disclose to stockbroker Peter Brant of Kidder, Peabody & Co., Inc. ("Kidder Peabody") the subject–matter (name of stock), general tenor (positive or negative) and probable publication date of forthcoming columns (T. 2078). At Winans' insistence, however, it was agreed that neither the accuracy nor the journalistic integrity of any article would be compromised, and this promise was fulfilled (T. 614, 877, 1883–85, 2079). With respect to the trades, Brant enlisted the assistance of petitioner Felis, Brant's colleague at Kidder Peabody, in whose account many of the trades were made. Under their arrangement, profits, if any, were to be split equally three ways (T. 2079–80).[7] Though Winans believed (correctly as it turned out) that discovery of this arrangement would result

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article entitled *Media Policies Vary on Preventing Employees and Others From Profiting On Knowledge of Future Business Stories*, the Journal reported that media policies concerning investments by reporters were the exception rather than the rule, and that the Journal's informal survey of media around the country showed that most newspapers and broadcasters had no policy at all.

6. At trial, the government expressly conceded that, in the absence of these rules, petitioners' conduct would not have violated the laws here employed. 612 F. Supp. at 842, 58a.

7. Petitioner Carpenter was not involved in any of these arrangements or in their execution, and was acquitted of the conspiracy charge based on them. Winans, however, unbeknownst to Brant and Felis, made a half–dozen small pre–publication trades in stocks he wrote about through a brokerage account that he opened in Carpenter's name. These resulted in total profits of $4,532.84. The 12 substantive securities, mail and wire fraud counts upon which Carpenter was convicted (as an aider and abetter) involved these trades.

in his dismissal from Dow Jones (T. 2228; Exh. GX-343 at 253-54), neither Winans, Brant nor Felis believed that they were acting illegally (T. 925, 1295, 1889).[8]

Though these facts were held to state a securities fraud, the sole alleged victim of the fraud charges was Dow Jones and not any securities investor. Moreover, Dow Jones was shown to have suffered no actual damage — tangible or reputational — and none was found by the district court.[9] Furthermore, neither the interstate wiring of Winans' (concededly accurate) articles from the Journal's offices in New York to its printing plant in Massachusetts, nor the subsequent mailings of the Journal to subscribers, were in any sense caused by the petitioners for any purpose whatever, let alone for the execution of their scheme; yet these wirings and mailings were held by the Court of Appeals to meet the statutory requirements of the mail and wire fraud statutes and to supply the requisite federal interest.

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8. Brant, who testified for the government at trial, pleaded guilty to conspiracy and securities fraud pursuant to an agreement with the government by the terms of which he must re-plead to other offenses if this Court disapproves the government's securities fraud theory.

9. Knowledge of Winans' arrangement with Peter Brant became public on March 29, 1984 (T. 106; Exhs. GX-38, 39). In the next quarter beginning April 1, 1984, Dow Jones' earnings, total revenues and advertising revenues all rose to record levels (T. 107, 252-57; Exh. W-A).

ARGUMENT

I.

Criminal Sanctions May Not Be Imposed On A Newspaper Columnist, Under SEC Rule 10b–5, For "Misappropriating" His Newspaper's Publication Schedule As Part Of A Scheme To Trade Certain Securities, Where The Newspaper Is The Only Alleged Victim Of Fraud And Has No Interest In The Securities Traded

In 1980, this Court "left for another day"[10] the question of whether an employee's unauthorized use, in purchasing securities, of information obtained by virtue of his employment constitutes securities fraud where he owes no duty to the seller. *Chiarella*, 445 U.S. at 235–36. Thereafter, the Second Circuit answered this question in the affirmative.[11] Now, in the instant case, the Second Circuit has taken this "misappropriation theory" of securities fraud, whose starting–point five years ago was the question reserved then and still not answered by this Court,[12] and extended it to a case having absolutely no bearing on the protection of the securities markets or investors. Petitioners urge that the day for review has now come, lest the lower courts continue the development of a body of law at odds with the language and intent of the Securities Exchange Act of 1934 ("1934 Act") and the recent teachings of this Court.

The extreme facts of this case make it one of first impression even for the Second Circuit, as the majority itself

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10. *Chiarella v. United States*, 445 U.S. 222, 238 (1980) (Stevens, J., concurring).

11. *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983). *See also SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985).

12. *Cf. Bateman Eichler, Hill Richards, Inc. v. Berner*, 105 S. Ct. 2622 (1985).

expressly found. 791 F.2d at 1027, 8a. The only basis for the securities fraud convictions was the violation of a financial newspaper's internal corporate policy. The only alleged victim of the securities fraud was the same newspaper, which had absolutely no interest in the purchase, sale or value of any of the securities traded by petitioners. The only alleged harm from the securities fraud in this case was the potential injury to the newspaper's reputation. As the dissent stated, section 10(b) "never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper." *Id.* at 1037, 29a (Miner, J., dissenting). Yet, that is the singular result of the holding below.[13]

In the Second Circuit's prior "misappropriation" cases (*Newman* and *Materia*),[14] there arguably existed a nexus between the fiduciary duties owed by the defendant–employees to their employers' market participant clients, the injuries to those market participants in their contemplated securities transactions, and the federal securities regulatory scheme.[15] The

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13. It was *not* part of the government's theory that Winans' articles were altered, or slanted, or falsified in any way in order to affect or manipulate the price of any stock. Nor were the articles "planted" for the purpose of "touting" or "publishing" any stock. As all parties agreed below, such conduct is proscribed under conventional theories of securities law which were not here invoked. *See, e.g.*, 15 U.S.C. § 77q(b).

14. *See supra* note 11; *infra* note 15.

15. The "misappropriation theory," as applied by the Second Circuit in *Newman* and *Materia* (and as hypothesized by this Court in *Chiarella*), was predicated upon breaches of the fiduciary duties owed by investment banks, financial printers and others similarly situated, and their respective employees, not to misappropriate confidential client information concerning proposed securities transactions such as tender offers. The victims of the misappropriations in *Newman* and *Materia* were market participants — corporations planning to engage in securities transactions in connection with contemplated tender offers. These market participants were injured in their securities transactions in that the defendants' conduct in *Newman* and *Materia* artificially inflated the "target company stock prices ... through purchases by purloiners of confidential information." *Newman*, 664 F.2d at 17. The misappropriated information was classic "market" information, i.e., information relating to the activities of investors, traders, brokerage firms, market–makers, and others involved in securities trading that affects the value of corporate securities.

tender offeror clients, who were injured in their securities transactions by a misappropriation of classic "market" information, were arguably intended beneficiaries of the securities laws.

The facts present in this case contrast starkly with those in prior "misappropriation" cases. As the lower courts found, Winans was not, by virtue of his position as an author of the Heard column, an insider of the corporations that were the subjects of his articles. Winans did not have a relationship with any of those corporations making him a "temporary insider," did not receive inside information in violation of any corporate insider's duty to his corporation's shareholders, and did not steal information from any corporate insider. *See Dirks v. SEC*, 463 U.S. 646 (1983). The only duty in this case was Winans' duty to his employer, Dow Jones, and that duty arose out of internal corporate workrules designed to safeguard a private corporation's concern for its reputation for journalistic integrity.[16] The criminality of Winans' conduct turned wholly upon the existence of a particular Dow Jones policy which the public had not even been told existed, which did not exist at most other newspapers, and which Dow Jones itself was free — legally — to ignore if it chose. Indeed, applying the "misappropriation theory" to a case in which there is no securities–related fiduciary duty or injury but only a breach of a non–securities–related internal corporate workrule gives rise to a legal anomaly: an employee commits securities fraud by trading on certain information, while his employer can trade on the very same information without violating the securities laws.[17] Yet,

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16. It is axiomatic that when an employee purloins confidential client information entrusted to his or her employer, the employer's reputation as a safe repository for client information will be implicated. But, although the reputations of the employers in *Newman* and *Materia* were found to have been harmed by their employees' misappropriations, these injuries alone did not support the application of the federal securities laws. It was the existence of duties to market–participant clients not to trade on their securities–related information that supported applications of the "misappropriation theory" in *Newman* and *Materia*.

17. Likewise, Winans could have purchased or sold securities based on advance knowledge of the publication schedules of his articles if he had been a "free–lancer" or if he had been writing for one of the majority of newspapers

from the perspective of the investor, and as concerns the securities markets, the impact of the employer's and employee's conduct is the same.[18]

The federal securities laws are not intended either to be a vehicle for the implementation of internal corporate policy or to uphold common–law agency principles that have traditionally been matters of state law. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), this Court held that violations of fiduciary duties affecting securities transactions registered under the 1934 Act are not actionable under section 10(b) when the duties fall within the arena of state law. The holding below, however, sweeps into the ambit of Rule 10b–5 any kind of fiduciary breach where securities are even tangentially involved, including, as here, silent infraction of a private company's workrules designed to safeguard reputation which have been specifically presented to employees as going beyond the requirements of the law.

The purpose of the federal securities laws is to protect investors, not reputations. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court noted that

> [f]ederal regulation of transactions in securities emerged as part of the aftermath of the market crash in 1929. The Securities Act of 1933 . . . was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing . . . The 1934 Act was intended principally to protect

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which did not have comparable workrules.

18. The Second Circuit recognized but allowed this capricious incidence of criminal liability, speculating that Dow Jones would not want to effectuate transactions that could harm its own reputation. 791 F.2d at 1033, 20a. On this approach, the entire application of the securities laws turns on how finicky a private employer may be about preserving its reputation when tempted by fast, and legal, profits.

> investors against manipulation of stock prices through regulation of transactions upon securities exchanges and in over–the–counter markets, and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges.

Id. at 194–95 (citations omitted); *see* S. Rep. No. 47, 73d Cong., 1st Sess. (1933) (purpose of Securities Act of 1933 to protect investing public). Both the majority and the dissent in this case recognized this primary function of the federal securities laws. *See* 791 F.2d at 1032, 18a (citing *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 235 (2d Cir. 1974) (majority)); 791 F.2d at 1037, 29a (citing *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 396 (2d Cir. 1967) (dissent)).

But the lower courts' decision here affords securities investors not one whit of added protection. The ordinary investor has no way of knowing whether a newspaper columnist is barred by the publisher's internal rules from advance trading on the information contained in the column. Nor, to the actual purchasers and sellers of the securities traded by petitioners, is it relevant whether the transactions were made by the employee Winans or the employer Dow Jones.[19]

The information upon which petitioners traded is also insufficient as a predicate for application of the federal securities laws. The information contained in Winans' articles was not inside information but rather information "fully available to the

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19. Indeed, through its flawed overextension of the "misappropriation theory" in this case, the Court of Appeals has in essence exhumed the parity–of–information rule buried by this Court in *Chiarella*. Even more troubling, the majority's decision allows *private employers* to determine when the parity–of–information rule will apply. Dow Jones may, as a matter of internal corporate policy, declare that its employees must in effect follow the parity–of–information rule and refrain from trading on advanced knowledge of articles scheduled to appear in the Journal. But, for the Second Circuit to convict Winans for securities fraud where neither he nor his employer had any independent duty to these investors, allows the employer to declare unlawful what this Court has declared *not* to be unlawful.

public," 791 F.2d at 1037, 28a (Miner, J., dissenting), and information which Winans was free to use in trading securities (as the government conceded below). The only "inside" information involved in this case was Dow Jones' publication schedule of the Heard column. That publication schedule, however, had nothing to do with the value or investment worthiness of any of the stocks which were the subject of Winans' columns, and does not even rise to the level of "outside" or "market" information. As the dissent noted:

> To say that the "publication schedule" of the Wall Street Journal was the non–public, confidential information stolen by the defendants is to extend the sweep of section 10(b) and rule 10b–5 beyond all reasonable bounds. Knowledge of publication dates simply is not the special securities–related knowledge implicated in the misappropriation theory. Moreover, it cannot be said that the schedules were secrets to which Winans always was privy, since he frequently did not know which writings would be published, when they would be published or even if they would be published.

Id., 28–29a. Basing criminal convictions on use of such information fails to afford securities investors one scintilla of added protection and does not in any way increase the integrity of the securities markets. Indeed, here, as in *Dirks*, the effect of the lower courts' decisions is, if anything, the opposite of what should be encouraged, since it provides an incentive to reporters to keep silent and trade on their acquired information, rather than to write articles about the information and, in so doing, preclude themselves from prepublication trading on the information. *See* 463 U.S. at 658.

Until the majority's decision in this case, Judge Miner continued, "the misappropriation theory of criminal liability for securities fraud was applied only in those cases involving the taking and use of non–public confidential *securities–related* information by those who obtain that information through special relationships with their sources of knowledge." 791 F.2d at 1036, 27–28a (emphasis in original) (citing *Materia* and

Newman). By using the federal securities laws to impose criminal penalties for breaches of internal corporate policy, the Second Circuit has caused tremendous confusion and doubt as to what types of relationships and what types of information are covered by section 10(b) and Rule 10b–5.[20] This unwarranted expansion of the securities laws does not enhance the integrity of the financial markets, may in fact discourage the prompt flow of important information to the public, and is a disservice to the rule of law.

II.

The Court Should Reject The Expansion Of The Mail And Wire Fraud Statutes To Cover Breaches Of Purely Private Workrules, Intangible Injuries, And Incidental Mailings And Wirings

The affirmance below of petitioners' mail and wire fraud convictions is a further, and major, step in the "recent...extraordinary expansion of the mail and wire fraud statutes"[21] to create, by judicial fiat, "a new crime — corporate improprieties — which entails neither fraud nor even a victim . . . ."[22] This recent trend, which has been the subject of a growing chorus of criticism from judges and scholars alike,[23] has never been approved by this Court. Moreover, it flies in the

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20. *See, e.g.*, Arkin, *Insider Trading, Distinguishing Unequal Advantage from Fraud*, N.Y.L.J., June 19, 1986, at 1, cols. 3–4; Herzel & Katz, *Insider Trading Cases: Right Result, Wrong Rules*, Legal Times, June 23, 1986, at 15; *Insider Trading: Outside Which Law?*, Economist, June 14, 1986, at 76; Karmel, *Market Information: Insider Trading*, N.Y.L.J., June 19, 1986, at 1, col. 1; Klein, *Winans Decision Defies Doctrinal Shift*, Legal Times, June 23, 1986, at 15; Lewin, *Some Assert S.E.C. Pushes Too Far*, N.Y. Times, July 21, 1986, at D–1, col. 3; Marcus, *Murky Inside–Trading Rules Often Point to Outsiders*, Washington Post, June 1, 1986; Obermaier, *Who's an Insider? What's Inside?*, N.Y.L.J., July 1, 1986, at 1, col. 1.

21. *Weiss*, 752 F.2d at 791 (Newman, J., dissenting).

22. *United States v. Siegel*, 717 F.2d 9, 24 (2d Cir. 1983) (Winter, J., dissenting).

23. *See* notes 55–57, *infra*.

face of the statutory language and contradicts this Court's earlier decisions construing these statutes.

On its face, the federal mail fraud statute, 18 U.S.C. § 1341, simply prohibits a person from using the mails for the purpose of executing a scheme to defraud. (The wire fraud statute, 18 U.S.C. § 1343, prohibits similar use of interstate wire communication, and identical principles govern the scope of the two statutes.)[24] When the mail fraud statute was enacted in 1872, the notion of fraud — defined at common law to cover only the obtaining of money or property by affirmatively false statements of existing facts — was sufficiently narrow that it required a decision of this Court[25] and an amendment by Congress[26] to make clear that the statute also reached the obtaining of money or property by false pretenses, representations, or promises as to the future.[27] Twice since then this Court has had occasion to caution against extending the statute beyond "pecuniary or property injury inflicted by a scheme to use the mails for the purpose."[28] Likewise, the Court has repeatedly reversed attempts to predicate mail fraud prosecutions on mailings that bear no purposeful relation to the fraudulent schemes in question.[29]

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24. *See, e.g., Siegel*, 717 F.2d at 14, and cases there cited.

25. *Durland v. United States*, 161 U.S. 306 (1896).

26. Act of March 4, 1909, ch. 321, § 215, 35 Stat. 1130.

27. *See* Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. 771, 811, 816 (1980); Comment, *The Intangible–Rights Doctrine and Political–Corruption Prosecutions Under The Federal Mail Fraud Statute*, 47 U. Chi. L. Rev. 562, 578 (1980). *See also United States v. Frankel*, 721 F.2d 917, 919–20 (3d Cir. 1983).

28. *Fasulo v. United States*, 272 U.S. 620, 628–29 (1926); *Hammerschmidt v. United States*, 265 U.S. 182, 189 (1924). *See also United States v. Curry*, 681 F.2d 406, 418 (5th Cir. 1982) (Garwood, J., concurring); *United States v. Caldwell*, 544 F.2d 691, 697 (4th Cir. 1976) (Widener, J., dissenting).

29. *United States v. Maze*, 414 U.S. 395 (1974); *Parr v. United States*, 363 U.S. 370, 389–94 (1960); *Kann v. United States*, 323 U.S. 88, 94 (1944). *See also United States v. Lane*, 106 S. Ct. 725, 733–34 (1986).

Yet, in the absence of more recent guidance from this Court, the lower courts have subjected the mail and wire fraud statutes to a vast judicial expansion — variously described as "extraordinary,"[30] "inexorable,"[31] and "seemingly limitless"[32] — that not only "eliminate[s] the need to show a substantial connection between the scheme to defraud and the use of the mails or wires...[but even] the need to show fraud" itself.[33] Where the statutes speak of a "scheme...to defraud," the lower courts have substituted a "breach of fiduciary duty."[34] Where the statutes speak of "obtaining money or property," the lower courts have substituted "deprivation of intangibles" such as "honesty," "loyalty," "privacy," "reputation," "time," "effort," or "expectations."[35] Where the statute speaks of a use of the mails that is for the "purpose" of executing the fraud, the lower courts have substituted a use of the mails that is a "reasonably foreseeable" accompaniment to the execution of the fraud.[36]

The instant case represents the culmination, and further extension, of these trends.

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30. *Weiss*, 752 F.2d at 791 (Newman, J., dissenting).

31. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting).

32. *Id.* at 14; *United States v. Margiotta*, 688 F.2d 108, 120 (2d Cir. 1982), *cert. denied*, 461 U.S. 913 (1983); *United States v. Von Barta*, 635 F.2d 999, 1001 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981).

33. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting).

34. *See, e.g., id.* at 14; *Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *United States v. Bronston*, 658 F.2d 920, 926 (2d Cir. 1981), *cert. denied*, 456 U.S. 915 (1982); *United States v. Isaacs*, 493 F.2d 1124 (7th Cir.), *cert. denied*, 417 U.S. 976 (1974); *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958).

35. *See, e.g., Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *Von Barta*, 635 F.2d at 1005–06; *United States v. Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980); *United States v. Condolon*, 600 F.2d 7, 9 (4th Cir. 1979); *United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896 (1978); *United States v. Keane*, 522 F.2d 534, 544 (7th Cir. 1975), *cert. denied*, 424 U.S. 976 (1976).

36. *See, e.g., United States v. Green*, 786 F.2d 247 (7th Cir. 1986); *United States v. Muni*, 668 F.2d 87 (2d Cir. 1981).

First, this decision represents the clearest example to date of the substitution of a vacuous concept of "breach of fiduciary duty" for the statutory requirement of fraud. Specifically, the majority's opinion, while paying lip–service to the reassuring dictum that "not every breach of an employee's fiduciary duty to his employer constitutes mail or wire fraud,"[37] nonetheless holds that Winans' fraud consisted *solely* of his failure to disclose to his employer (the Wall Street Journal) that he had breached the Journal's private rules of confidentiality by disclosing its publication schedule in advance.[38] There is no principled distinction between this and any other breach of an employee's fiduciary duty to his employer, no matter how minor.

The implications of such a rule of law are staggering. Disobedience to any internal workrule may give rise to a mail fraud or wire fraud violation, no matter how technical the rule or trivial the conduct it prohibits, even where there is no discernible federal interest in regulating the employment relationship. Nor does it matter that the rule was imposed unilaterally by the employer,[39] had no obvious correlative either in public law[40] or

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37. 791 F.2d at 1035, 24a.

38. *Id.* The rules in question — convoluted, ambiguous, and technical — were hidden at the back of a 40–page pamphlet given to new Journal employees. It defies common sense that any new employee read them carefully, let alone remembered them. Moreover, even on their face, the rules did not separately require disclosure to the Journal of breaches of its confidentiality policy. Thus, even assuming Winans' prepublication use of the schedule was a "misappropriation" of information, 791 F.2d at 1034, 23a, his conduct did not violate any express "duty to disclose" that misappropriation to the Journal. Thus, his conduct is deemed fraudulent only because the Court of Appeals effectively holds that there is an *inherent* duty to disclose to one's employer a breach of that employer's workrules. This is precisely the "bootstrap" approach to mail fraud condemned in the Second Circuit's earlier opinion in *Newman*, 664 F.2d at 19.

39. The Journal's workrules were neither quoted nor referred to in the collective bargaining agreement governing Winans' employment (A100).

40. *See United States v. Pisani*, 773 F.2d 397, 410 (2d Cir. 1985) (mail fraud conviction reversed because alleged fraud was not prohibited by state statute).

even common industry practices,[41] and was made known to the employee (if at all) only after the employment was commenced.[42] Violation of the rule now constitutes grounds not only for discharge but also for a federal criminal prosecution. Indeed, even a non–employee who has no better than a "general awareness" of the workrule (Carpenter)[43] or no awareness whatever (Felis)[44] can be criminally prosecuted if he assists the employee in the activities that violate the workrule.

Thus, the decision below gives every employer the power to decide what acts are indictable as felonies and thereby usurps a role heretofore reserved to the legislature.[45] Even more dangerously, the practical effect of criminalizing every workrule breach is to give prosecutors almost total discretion in determining, after the fact, what conduct constitutes a crime and who should be criminally prosecuted.[46]

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41. According to the Journal, workrules restricting a reporter's trading of securities are the exception rather than the rule. *See Media Policies Vary on Preventing Employees and Others from Profiting on Knowledge of Future Business Stories*, Wall Street J., March 2, 1984 (A100).

42. 612 F. Supp. at 829, 35a. The Journal's conflicts of interest policy was first disclosed to its readers in a news article on March 2, 1984 — after the last securities trade alleged in the indictment (A47–49).

43. 612 F. Supp. at 831, 38a; *see United States v. Frade*, 709 F.2d 1387, 1392 (11th Cir. 1983) ("The finding that a defendant is aware that his conduct is generally unlawful is insufficient to sustain a finding of guilt under a statute requiring specific intent").

44. *See United States v. Ballard*, 663 F.2d 534, 543 (5th Cir. 1981) (reversing convictions of mail fraud, conspiracy and aiding and abetting when there was no evidence that defendants knew of the duty owed by codefendant–principal).

45. Neither Congress nor the New York State legislature has deemed the public interest to require protecting a newspaper's publication schedule through criminal penalties or even civil liabilities. The New York Penal Law, for example, limits the crime of unlawful use of private, confidential information to a narrowly defined category of "secret scientific material." N.Y. PENAL LAW § 165.07 (McKinney 1975 & Supp. 1986). *See also id.* § 155.00 [subd. 6].

46. *See* Jeffries, *Legality, Vagueness and the Construction of Penal Statutes*, 71 Va. L. Rev. 189, 190–201 (1985).

Nor is the power to criminalize private rules limited to breaches of employer workrules. The Court of Appeals' decision creates a federal felony wherever there may be said to be a "breach of fiduciary duty," a phrase that, as this Court has noted, "only begins an analysis" rather than provides guidance or certainty.[47] Yet, the decision below and its immediate precedents effectively "read the wire fraud statute to embody a federal law of fiduciary obligations, including an undefined duty of yet further disclosure, enforceable by the sanctions of criminal law."[48] No more should this be permitted under the language of the mail and wire fraud statutes than it is permitted under the (if anything) broader language of the securities fraud statutes. *See Chiarella*, 445 U.S. at 234–35.

Second, this decision extends the "deprivation of intangibles" approach to the mail fraud requirement that the defendant intend actual harm to his victim,[49] by holding that such harm can include harm to a newspaper's "reputation for professionalism." 791 F.2d at 1035, 24a. Quite aside from the total absence of any finding or evidence that petitioners intended such harm,[50] the simple truth is that if a concept as loose as "reputation for professionalism" can satisfy the harm requirement of the mail and wire fraud statutes, then the requirement has effectively been eliminated *sub silentio*.

The sole interest protected by this prosecution — *viz.*, a newspaper's reputation — is not the kind of interest that has

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47. *SEC v. Chenery Corp.*, 318 U.S. 80, 85–86 (1943) (Frankfurter, J.). *See also Bronston*, 658 F.2d at 931 (Van Graafeiland, J., dissenting). The difficulties faced by the district courts in discerning the new criminal reach of "fiduciary duty" are made forcefully apparent in *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y.), *rev'd on other grounds*, 773 F.2d 477 (2d Cir. 1985) (mail fraud indictment of son for alleged breach of fiduciary duty to father).

48. *Seigel*, 717 F.2d at 24 (Winter, J., dissenting).

49. *See, e.g., United States v. Regent Office Supply Co.*, 421 F.2d 1174 (2d Cir. 1970).

50. Instead of finding actual harm or intent to harm, the district court merely *presumed* harm from the fiduciary breach itself. 612 F. Supp. at 845–46, 64a.

historically been held to warrant the invocation of society's severest sanction, criminal penalties. Just as the dissent here notes that "[h]arm to reputation . . . never has been recognized as a proper subject for redress under section 10(b) or rule 10b–5," 791 F.2d at 1037, 29a, so too it has never before been recognized as a proper subject for redress under the mail or wire fraud statutes.[51] Such a qualitative extension of the scope of the criminal statutes should be left to the legislature.[52]

Third, the decision, in holding that the mailings and wirings in this case were adequate because they were "important" to the success of the scheme and were "reasonably foreseeable" by the defendants, 791 F.2d at 1035, 24–25a, studiously ignores not only the relevant precedents of this Court (such as *Maze*, *Parr*, and *Kann*, *supra* note 29), but also the statutory language itself, which requires that the defendants "cause" these mailings or interstate wirings for the "purpose" of executing their fraudulent scheme. Winans' job was to write accurate columns for the Journal, which, along with the rest of the text of the paper, were then conveyed by interstate wire communication (the predicate wirings) to the printing plant, from where the paper was distributed, partly by mail (the predicate mailings), to its subscribers. The alleged fraud did not change any of this one iota. Neither the timing nor the accuracy of the columns was affected; the wire transmission in form and content was exactly what it would have been in the absence of Winans' breach of the Journal's workrules. Nor were the mailings even directed to the only alleged victim of fraud, the Wall Street Journal; indeed, on the theory of this prosecution, the "fraud" — consisting of Winans' unauthorized use of the Journal's publication schedule — was

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51. In so stating, the dissent here, and we, discount the "sullying of reputation" language in *Newman*, 664 F.2d at 17, as pure dictum; but, in any event, *Newman* suffers from many of the same infirmities as the decision here. Indeed, one major reason for the over-expansion of the mail and wire fraud statutes is that it has occurred piecemeal with one panel building ever further on an earlier panel's decision, without stepping back to examine the overall effect of the progression.

52. *Dowling v. United States*, 105 S. Ct. 3127, 3132 (1985). *See also* Jeffries, *supra* note 46, at 202–05.

entirely completed before any relevant mailing or interstate wiring occurred.

To be sure, the defendants took advantage of the fact that Winans' columns would be printed and distributed to realize certain financial benefits from their arrangement. But to equate this with the statutory requirement that they "cause" the mailings and wirings "for the purpose" of executing their scheme is to deprive the statutory words of their ordinary meaning. In no linguistically recognized sense did the defendants "cause" these mailings and wirings, let alone cause them for the "purpose" of furthering their scheme.[53] As Judge Posner recently noted:

> The distinction between mailing a letter to execute a fraud and merely taking advantage of a criminal opportunity created by a letter sent for a lawful purpose is at the heart of *Parr v. United States*, 363 U.S. 370 (1960) ... .
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> • • •
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> Missing from both *Parr* and this case is a causal connection between the purpose and the mailings; the mailings would have occurred anyway. This point has been a ground of decision in other cases besides *Parr* — showing that *Parr* is not some legal sport that we are free to ignore because the other courts of appeals have ignored it. See *United States v. Curry*, 681 F.2d 406, 412 (5th Cir. 1982); *United States v. Boyd*, 606 F.2d 792, 794 (8th Cir. 1979) (alternative holding); cf.

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53. Almost every radio and television station in the country transmits interstate. Many, if not most, newspapers and magazines are mailed. Under the government's theory, if consistently applied, reporting of true, accurate and non-misleading information becomes a criminal fraud if assisted by a journalist or editor whose undisclosed self-interest (political, emotional, or economic) in the subject-matter of the report — though it does not affect the accuracy of his reporting — could be a source of embarrassment to his employer.

United States v. Brown, 540 F.2d 364, 377 (8th Cir. 1976).[54]

On every score, then, this decision marks the furthest extension to date of the recent "limitless" expansion of the mail and wire fraud statutes. As noted, previous steps in that expansion have been severely criticized in dissenting opinions in the Second Circuit,[55] and in dissenting, concurring, and even majority opinions in other Circuits.[56] The near–unanimous weight of

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54. *Green*, 786 F.2d at 256–58 (Posner, J., dissenting). The majority in *Green* similarly believed that *Parr* "may require proof that [the predicate] mailings were used with specific intent to defraud the recipients of the mail," but found that such proof had been adduced in *Green*. No such proof was adduced here, however, nor could it be. Thus, the Second Circuit's position is seemingly at odds with that of the Seventh (and other) Circuits. *See also United States v. Castile*, 795 F.2d 1273 (6th Cir. 1986); *United States v. Tarnopol*, 561 F.2d 466 (3d Cir. 1977).

55. *See, e.g., Weiss*, 752 F.2d at 791–95 (Newman, J., dissenting); *Siegel*, 717 F.2d at 23–24 (Winter, J., dissenting); *Margiotta*, 688 F.2d at 139–44 (Winter, J., dissenting); *Bronston*, 658 F.2d at 930–33 (Van Graafeiland, J., dissenting). *See also Pisani*, 773 F.2d at 410 (Pratt, J.) (reversing mail fraud conviction based on fiduciary breach); *United States v. Dixon*, 536 F.2d 1388, 1398–1401 (2d Cir. 1976) (Friendly, J.) (reversing mail fraud conviction held to be "a considerable distance from the ordinary meaning of 'scheme or artifice to defraud'"). Many of the Second Circuit decisions extending the mail and wire fraud statutes reversed decisions by thoughtful district judges, who, even within the confines of prior Second Circuit precedents, did not believe that the statutes could be further stretched. *See, e.g., Newman*, 664 F.2d 12 (reversing dismissal of indictment by Haight, J.); *Von Barta*, 635 F.2d 999 (reversing dismissal of indictment by Brieant, J.).

56. *E.g., United States v. Hewes*, 729 F.2d 1302, 1322 (11th Cir. 1984), *cert. denied sub nom. Caldwell v. United States*, 105 S. Ct. 790 (1985); *United States v. Lemire*, 720 F.2d 1327, 1335–36 (D.C. Cir. 1983) (majority opinion expressing "second thoughts" about expansion of mail fraud, and rejecting government's theory that "would criminalize any intentional undisclosed breach of duty to an employer"), *cert. denied*, 467 U.S. 1226 (1984); *Curry*, 681 F.2d at 418–25 (Garwood, J., concurring) (expressing disagreement with "intangible rights" theory of mail fraud); *United States v. Rabbitt*, 583 F.2d 1014 (8th Cir. 1978), *cert. denied*, 439 U.S. 1116 (1979); *United States v. Craig*, 573 F.2d 455, 497–505 (7th Cir. 1977) (Swygert, J., dissenting) (describing the extension of the mail and wire fraud statutes as a

scholarly opinion has condemned the trend.[57] It is high time for this Court to review it, and reverse it.

"pernicious trend"), *cert. denied*, 439 U.S. 820 (1978); *Caldwell*, 544 F.2d at 697–98 (Widener, J., concurring) (suggesting limitation of mail fraud prosecutions to defrauding of tangibles); *United States v. McNeive*, 536 F.2d 1245 (8th Cir. 1976); *United States v. Edwards*, 458 F.2d 875, 880 (5th Cir.), *cert. denied sub nom. Huie v. United States*, 409 U.S. 891 (1970); *United States v. Kelem*, 416 F.2d 346, 347 (9th Cir. 1969), *cert. denied*, 397 U.S. 952 (1970).

57. *See, e.g.*, Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 Am. Crim. L. Rev. 117 (1981) (criticizing the entire development, especially as applied in *Bronston*); Jeffries, *supra* note 46 (criticizing as "case-by-case criminalization" the extension of the mail fraud statute to fiduciary breaches as applied in *Margiotta*); Tigar, *Mail Fraud, Morals, and U.S. Attorneys*, 11 LITIGATION 22 (Fall 1984); Note, *Intra-Corporate Mail and Wire Fraud: Criminal Liability for Fiduciary Breach*, 94 Yale L.J. 1427 (1985) (criticizing the mail fraud fiduciary breach standard as "untenable" as applied in *Siegel* and *Weiss*). *See also* Coffee, *The Metastasis of Mail Fraud: The Continuing Story of the "Evolution" of a White-Collar Crime*, 21 Am. Crim. L. Rev. 1 (1983); Hurson, *Limiting the Federal Mail Fraud Statute—A Legislative Approach*, 20 Am. Crim. L. Rev. 423 (1983); Comment, *supra* note 27, at 578.

CONCLUSION

For the foregoing reasons, petitioners respectfully pray that the Court issue writ of certiorari to review the judgments of the Court of Appeals for the Second Circuit.

Dated: September 15, 1986

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 546, 524, 525—August Term, 1985

(Argued: November 26, 1985 Decided: May 27, 1986)

Docket Nos. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

Appellee,

—v.—

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,

Defendants-Appellants.

Before:

MANSFIELD, PIERCE and MINER,

Circuit Judges.

Appeal from judgments of conviction entered after a non-jury trial in the United States District Court for the Southern District of New York, Stewart, *Judge*, for securities fraud, mail and wire fraud, aiding and abetting,

and conspiracy to misappropriate material, nonpublic information from the *Wall Street Journal* in connection with the purchase and sale of securities.

Affirmed in part and reversed in part.

Miner, Circuit Judge, dissents in part in a separate opinion.

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—and—

Daniel L. Goelzer, Esq., Jacob H. Stillman, Esq., Rosalind C. Cohen, Esq., Richard A. Levine, Esq. (Paul Gonson, Esq., of counsel), on the brief for the Securities and Exchange Commission, Washington, D.C., *as Amicus Curiae*.

Benjamin W. Heineman, Jr., Esq., Carter G. Phillips, Esq., and Mark D. Hopson, Esq. (Sidley & Austin, Washington, D.C., of counsel), on the brief for the Reporters' Committee for Freedom of the Press, the National Association of Broadcasters, the New York Financial Writers Association, the Media Institute, the Newspaper Guild, the Radio-Television News Directors Association, the American Society of Magazine Editors, the National Newspaper Association, and the Associated Press Managing Editors, *as Amici Curiae in support of Defendants-Appellants*.

PIERCE, *Circuit Judge*:

This is an appeal from judgments of conviction in the United States District Court for the Southern District of New York, Charles E. Stewart, Jr., *Judge*, entered after a twenty-day non-jury trial, following which Winans and Felis were found guilty of securities fraud by misappropriating material, nonpublic information from the *Wall*

Street Journal ("*Journal*") in connection with the purchase and sale of securities, and of mail and wire fraud. Winans and Felis were also convicted of conspiracy to commit such securities and mail and wire frauds and to obstruct justice. Carpenter was convicted of aiding and abetting in the commission of securities fraud and mail and wire fraud. *United States v. Winans, et al.*, 612 F. Supp. 827 (S.D.N.Y. 1985).

Appellants contend, *inter alia*, that they may not be held criminally liable for violating, or conspiring to violate or aiding and abetting in violating, section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78ff, and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, because they were not corporate insiders or "quasi-insiders" and did not misappropriate material nonpublic information from such insiders or "quasi-insiders."

We hold that section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 proscribe an employee's unlawful misappropriation from his employer, a financial newspaper, of material nonpublic information in the form of the newspaper's forthcoming publication schedule, in connection with a scheme to purchase and sell securities to be analyzed or otherwise discussed in future columns in that newspaper, and that the use of the newspaper's interstate wire and mail production and distribution channels for purposes of effectuating said scheme may serve as a predicate for criminal liability for mail and wire fraud. We therefore affirm the convictions based on these substantive counts. We also affirm the district court's conviction of defendants Winans and Felis of conspiracy and of defendant Carpenter of aiding and abetting. However, we reverse Winans' conviction of conspiracy to the extent

that it is based upon certain trades made between Felis and a third party, named Stephen Spratt, since these transactions were not within the scope of the unlawful agreement to trade on the misappropriated information.

Affirmed in part and reversed in part.

BACKGROUND

Defendants Kenneth P. Felis ("Felis"), and R. Foster Winans ("Winans") appeal from judgments of conviction for federal securities fraud in violation of section 10(b) of the 1934 Act and Rule 10b-5; mail fraud in violation of 18 U.S.C. § 1341; and wire fraud in violation of 18 U.S.C. § 1343, all in connection with certain securities trades conducted on the basis of material, nonpublic information regarding the subject securities contained in certain articles to be published in the *Wall Street Journal*. Winans and Felis also appeal from judgments of conviction for conspiracy to commit securities fraud and mail and wire fraud and to obstruct justice, in violation of 18 U.S.C. § 371, and David Carpenter ("Carpenter") appeals from a judgment of conviction for aiding and abetting.

Since March 1981, Winans was a *Wall Street Journal* reporter and one of the writers of the "Heard on the Street" column (the "Heard" column), a widely read and influential column in the *Journal*. Carpenter worked as a news clerk at the *Journal* from December 1981 through May 1983. Felis, who was a stockbroker at the brokerage house of Kidder Peabody, had been brought to that firm by another Kidder Peabody stockbroker, Peter Brant ("Brant"), Felis' longtime friend who later became the government's key witness in this case.

Since February 2, 1981, it was the practice of Dow Jones, the parent company of the *Wall Street Journal*, to distribute to all new employees "The Insider Story," a forty-page manual with seven pages devoted to the company's conflicts of interest policy. The district judge found that both Winans and Carpenter knew that company policy deemed all news material gleaned by an employee during the course of employment to be company property and that company policy required employees to treat nonpublic information learned on the job as confidential.[1]

Notwithstanding company policy, Winans participated in a scheme with Brant and later Felis and Carpenter in which Winans agreed to provide the two stockbrokers (Brant and Felis) with securities-related information that was scheduled to appear in "Heard" columns; based on this advance information the two brokers would buy or sell the subject securities. Carpenter, who was involved in a private, personal, non-business relationship with Winans, served primarily as a messenger between the conspirators. Trading accounts were established in the names of Felis, Carpenter, Winans, Brant, David Clark, Western Hemisphere, and Stephen Spratt.[2] During 1983 and early 1984, defendants made prepublication trades on the basis of their advance knowledge of approximately

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1 The district court found that whether confidentiality constituted a company "policy" or "practice" is a distinction without merit. Rather, it found significant that Winans had actual knowledge of the policy and that Carpenter was aware generally of the policy. 612 F. Supp. at 831.

2 David Clark refers to one of Brant's clients. Stephen Spratt refers to a friend of Felis. Western Hemisphere was the name on a Swiss bank account that Felis and Winans used after Kidder Peabody's Compliance Department became suspicious that Felis had pre-publication knowledge regarding certain "Heard" columns.

twenty-seven *Wall Street Journal* "Heard" columns, although not all of those columns were written by Winans. Generally, Winans would inform Brant of the subject of an article the day before its scheduled publication. Winans usually made his calls to Brant from a pay phone, and often used a fictitious name. The net profits from the scheme approached $690,000. The district court found that this scheme did not affect the subject matter or quality of Winans's columns, since "[m]aintaining the journalistic purity of the column was actually consistent with the goals of the conspirators," given that the predictability of the columns' market impact depended in large part on the perceived quality and integrity of the columns. 612 F. Supp. at 835 n.4.

In November 1983, when Kidder Peabody's Compliance Department noticed a correlation between "Heard" articles and trading in the Felis and Clark accoun[illegible] Felis was questioned by a Kidder Peabody supervisor. Felis denied any impropriety. However, he and Brant moved certain funds among accounts to conceal the continued operation of the scheme. Indeed, Felis had previously advised his friend, Stephen Spratt, to whom he had provided advance information on four occasions, to change the names on certain accounts so as to avoid being discovered. When the SEC began inquiring into the scheme, Clark and Brant both made misstatements to agency officials, and Carpenter produced false invoices that apparently had been designed to conceal the truth from the SEC. Later, on March 29, 1984, Winans and Carpenter voluntarily testified fully at the SEC about this and about the scheme.

DISCUSSION

The fairness and integrity of conduct within the securities markets is a concern of utmost significance for the proper functioning of our securities laws. In broadly proscribing "deceptive" practices in connection with the purchase or sale of securities pursuant to section 10(b) of the Securities Exchange Act of 1934, Congress left to the courts the difficult task of interpreting legislatively defined but broadly stated principles insofar as they apply in particular cases. This case requires us to decide principally whether a newspaper reporter, a former newspaper clerk, and a stockbroker, acting in concert, criminally violated or conspired to violate or aided and abetted in the violation of federal securities laws by misappropriating material, nonpublic information in the form of the timing and content of the *Wall Street Journal's* confidential schedule of columns of acknowledged influence in the securities market, in contravention of the established policy of the newspaper, for their own profit in connection with the purchase and sale of securities.

I.

Although the facts render the securities fraud issue herein one of first impression, we do not write on a clean slate in assessing whether this case falls within the purview of the "misappropriation" theory of section 10(b) and Rule 10b–5 thereunder.[3] In 1980, the Supreme Court

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[3] Section 10(b), 15 U.S.C. § 78j(b), prohibits the use "in connection with the purchase or sale of any security. . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. . . ."

Rule 10b–5, 17 C.F.R. § 240.10b–5, states:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

left open the question of the viability of that theory, *Chiarella v. United States*, 445 U.S. 222 (1980), with the concurring and dissenting opinions suggesting that had the theory been presented to the jury, Chiarella's conviction might have been affirmed.[4] Since then, the theory

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(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

4 In Chief Justice Burger's view, the employee's conviction should have been affirmed because "the evidence shows beyond all doubt that Chiarella, working literally in the shadows of the warning signs [stating employer's confidentiality policy] in the printshop misappropriated—stole, to put it bluntly—nonpublic information entrusted to him in the utmost confidence." *Chiarella*, 445 U.S. at 245 (Burger, C.J., dissenting). Justice Brennan, while disagreeing with the Chief Justice's view of the evidence, agreed that "a person violates § 10(b) whenever he improperly obtains or converts to his own benefit nonpublic information which he then uses in connection with the purchase or sale of securities." *Id.* at 239 (Brennan, J., concurring). Justice Blackmun, with whom Justice Marshall joined, wrote more broadly that even without resting Chiarella's conviction on a "misappropriation" theory, it was enough that the employee "purloined," *id.* at 246 (Blackmun, J., dissenting), information to which he had unique access by virtue of his position and the trust that attached to that position, *id.* at 246-52 (Blackmun, J., dissenting). Justice Stevens, while concurring in the opinion of the Court, wrote separately "to emphasize the fact that we have not necessarily placed any stamp of approval on what this petitioner did, nor have we held that similar actions must be considered lawful in the future." *Id.* at 238 (Stevens, J., concurring). Further, wrote Justice Stevens, the Court manifestly left open the question of whether the conviction could have been affirmed on grounds of misappropriation since that theory had not been presented to the jury.

We also note that the Court recently reiterated that tippee liability under section 10(b) may arise not only from participation in an insider's breach of fiduciary duty, but also where a tippee "otherwise 'misappropriate[s] or illegally obtains[s] the information.' " *Eichler v. Berner*, 105 S. Ct. 2622, 2630 & n.22 (1985) (quoting *Dirks v. SEC*, 463 U.S. 646, 665 (1983); citing H. Rep. No. 98-355 at 14-15 (1983), *reprinted in* [1984] U.S. Code Cong. & Ad. News 2274).

has been applied twice by this court. *See SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985); *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983). It is clear that defendant Winans, as an employee of the *Wall Street Journal*, breached a duty of confidentiality to his employer by misappropriating from the *Journal* confidential prepublication information, regarding the timing and content of certain newspaper columns, about which he learned in the course of his employment.[5] We are presented with the question of whether that unlawful conduct may serve as the predicate for the securities fraud charges herein.

The core of appellants' argument is that *Newman* and *Materia* are inapposite because in those cases the information was misappropriated by employees who owed a duty of confidentiality not only to their employers, but also to their employers' clients, the corporations whose securities were traded. In other words, appellants argue, the misappropriation theory may be applied only where the information is misappropriated by corporate insiders or so-called quasi-insiders, *Dirks v. SEC*, 463 U.S 646, 655 n.14 (1983), who owe to the corporation and its shareholders a fiduciary duty of abstention or disclosure.

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5 *See, e.g.*, Rest. Agency 2d § 395, which provides:

> Unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as agent, in competition with or to the injury of the principal, on his own account or on behalf of another, although such information does not relate to the transaction in which he is then employed, unless the information is a matter of general knowledge.

The general tort of breach of a duty of confidentiality to an employer is, of course, well-settled. *See, e.g., Franke v. Wiltschek*, 209 F.2d 493, 495 (2d Cir. 1953) (citing authority).

Thus, appellants would have us hold that it was not enough that Winans breached a duty of confidentiality to his employer, the *Wall Street Journal*, in misappropriating and trading on material nonpublic information; he would have to have breached a duty to the corporations or shareholders thereof whose stock they purchased or sold on the basis of that information.

Appellants read *Newman* and *Materia* and interpret the misappropriation theory too narrowly. Notwithstanding the existence of corporate clients of the employers in *Newman* and *Materia*, the misappropriation theory more broadly proscribes the conversion by "insiders" *or others* of material non-public information in connection with the purchase or sale of securities. *See Materia*, 745 F.2d at 203 (liability may arise merely because one "misappropriates non-public information in breach of a fiduciary duty and trades on that information to his advantage"); *id.* at 201 (section 10(b) was not "aimed solely at the eradication of fraudulent trading by corporate insiders"); *cf. Newman*, 664 F.2d at 17 ("the language of Rule 10b-5 . . . contains no specific requirement that fraud be perpetrated upon the seller or buyer of securities"); *SEC v. Musella*, 578 F. Supp. 425, 438 (S.D.N.Y. 1984) (*Newman* "gave legal effect to the commonsensical view that trading on the basis of improperly obtained information is fundamentally unfair, and that distinctions premised on the source of the information undermine the prophylactic intent of the securities laws"). It is precisely such conversion that serves as the predicate for the convictions herein.

Although *Dirks* disapproved of certain trading by insiders or quasi-insiders who owe a fiduciary duty to investors, courts are not thereby constrained from recog-

nizing other misconduct. To give *Dirks* such preclusive effect would suggest that one application of a statute cannot admit of another application not raised in the first case. As the district court correctly stated, "[i]t is not accurate to say that *Dirks* wrote the book on insider or outsider trading; it wrote one chapter with respect to one type of fraudulent trading." 612 F. Supp. at 842. Indeed, the chapter that *Dirks* wrote derives from prior jurisprudence in which "fine distinctions and rigid classifications" were appropriately foresaken to facilitate the recognition of significant doctrinal reasons for holding members of particular, even if new, groups liable. *See In Re Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961) (liability not restricted to "traditional" insiders such as officers, directors and controlling stockholders), *cited approvingly in Dirks*, 463 U.S. at 653. Given the broad remedial purposes of the securities laws, the Supreme Court has "repeatedly recognized that securities laws combatting fraud should be construed 'not technically and restrictively but flexibly,' " *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)). Other cases involving the misappropriation theory have distinguished *Dirks* substantially for the reasons stated in the district court opinion. *SEC v. Materia*, [1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶¶ 99,526, 99,543 (S.D.N.Y. 1983), *aff'd*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985); *SEC v. Musella*, 578 F. Supp. at 437-43; *United States v. Reed*, 601 F. Supp. 685, 699-703 (S.D.N.Y. 1985), *rev'd in part*, 773 F.2d 477 (2d Cir. 1985) (reinstating perjury and obstruction counts).

Further, we think that the application of the misappropriation theory herein promotes the purposes and policies

underlying section 10(b) and Rule 10b-5. In construing the Rule's meaning, we must begin with its language. *Chiarella*, 445 U.S. at 226; *Santa Fe Industries v. Green*, 430 U.S. 462, 472 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976). The Rule prohibits "*any* person," acting "directly or indirectly," from employing "*any* device, scheme or artifice to defraud." It equally prohibits "*any* act, practice, or course of business which operates as a fraud or deceit upon *any* person." 17 C.F.R. § 240.10b-5 (emphasis added). This repeated use of the word "any" evidences Congress' intention to draft the Rule broadly. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972). The Supreme Court has recognized that section 10(b) of the 1934 Act, as implemented by Rule 10b-5, "was designed as a catchall clause to prevent fraudulent practices." *Chiarella*, 445 U.S. at 226 (citing *Ernst & Ernst*, 425 U.S. at 202, 206).

The legislative intent of the 1934 Act is similarly broad-reaching. As this Court has noted in applying the misappropriation theory, "the antifraud provision was intended to be broad in scope, encompassing all 'manipulative and deceptive practices which have been demonstrated to fulfill no useful function.' " *Materia*, 745 F.2d at 201 (quoting S. Rep. No. 792, 73d Cong., 2d Sess., 6 (1934)). We perceive nothing "useful" about defendants' scheme. Nor, in our view, could any purported function of the scheme[6] be considered protected given Congress' stated concern for the perception of fairness and integrity

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6 *See, e.g.*, Farley, *A Current Look at the Law of Insider Trading*, 39 Bus. Law. 1771, 1782 (1984) (defending "misappropriation" as facilitating the transfer of information vital to market efficiency); *cf.* Fischel, *Insider Trading and Investment Analysts: An Economic Analysis of* Dirks v. Securities and Exchange Commission, 8 Hofstra L. Rev. 127, 133 (1984) (defending *Dirks* on same grounds).

in the securities markets and the potential costs of foresaking such legislated concerns, including fewer market participants and greater reliance on fraud as a means of competing in the market. *See, e.g.*, H.R. 9323, 73d Cong., 2d Sess., Rept. No. 1383 at 7865-66, *reprinted in* 1 Federal Bar Association Securities Law Committee, *Federal Securities Laws* 856-57 (1983) ("a wise and judicious administration of the provisions of this [A]ct will create a new confidence in the integrity of the securit[ies] markets"); Twentieth Century Survey and Study, *cited in* H.R. 9323, *supra*, at 7866, *reprinted in* Federal Securities Laws, *supra*, at 857 (seeking to create "a justifiable belief that securit[ies] markets actually were 'free and open' ").

In construing Congressional intent, we also find persuasive Congress' recent statements accompanying the Insider Trading Sanctions Act of 1984, P.L. No. 98-376, 98 Stat. 1264 (1984), relating to the purposes and scope of the 1934 Act and its antifraud provisions. *See Eichler v. Berner*, 105 S. Ct. 2622, 2630 n.23, 2633 n.32 (1985) (construing section 10(b) in light of the provisions and legislative history of the Insider Trading Sanctions Act of 1984); *see also Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 380-81 (1969) (subsequent legislative history "entitled to great weight in [prior] statutory construction"); *Consolidated Edison Co. v. United States*, 782 F.2d 322, 324 n.3 (2d Cir. 1986) (per curiam) (noting persuasiveness of subsequent legislative history as to meaning of prior law). The use of subsequent legislative history is especially appropriate where, as here, the original history is limited. *See Santa Fe Industries v. Green*, 430 U.S. 462, 473 n.13 (1977) (noting paucity of legislative history on section 10(b)); *Ernst & Ernst*, 425 U.S. at 202 (same). In enacting the Insider Trading Sanctions Act

of 1984, Congress noted that the intent of the 1934 Act was to condemn all manipulative or deceptive trading "whether the information about a corporation or its securities originates from inside or outside the corporation." H.R. Rep. No. 98-355, 98th Cong., 1st Sess. 3, 4 (1983), *reprinted in* [1984] U.S. Code Cong. & Ad. News 2274. Further, the reason for this view was clearly stated: "the abuses sought to be remedied [by section 10(b)] were not limited to actions of corporate insiders and large shareholders." *Id.* Clearly, Congress has understood its predecessors to have delineated illegal conduct along the lines not simply of relationships to corporations and duties arising thereunder, as developed by the line of cases through *Cady, Roberts* and *Dirks*. Rather, Congress apparently has sought to proscribe as well trading on material, nonpublic information obtained not through skill but through a variety of "deceptive" practices, unlawful acts which we term "misappropriation." *See* Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101, 106 & n.33 (1984).[7]

We do not say that merely using information not available or accessible to others gives rise to a violation of Rule 10b-5. That theory of 10b-5 liability has been rejected. *See Chiarella*, 445 U.S. at 235 (rejecting "parity of information" theory); *id.* at 235 n.20 (rejecting "access to information" theory). There are disparities in knowl-

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[7] *See also* ABA Committee on Federal Regulation of Securities, Report of the Task Force on Regulation of Insider Trading—Part I: Regulation under the Antifraud Provisions of the Securities Exchange Act of 1934, 41 Bus. Law. 223, 235-37, 253-63, 270-71 (1985) (reviewing misappropriation cases and proposing express codification of misappropriation theory without limitation to insiders, quasi-insiders or their tippees).

edge and the availability thereof at many levels of market functioning that the law does not presume to address. However, the critical issue is found in the district judge's careful distinction between "information" and "conduct." 612 F. Supp. at 842. Whatever may be the legal significance of merely using one's privileged or unique position to obtain material, nonpublic information, here we address specifically whether an employee's use of such information in breach of a duty of confidentiality to an employer serves as an adequate predicate for a securities violation. Obviously, one may gain a competitive advantage in the marketplace through conduct constituting skill, foresight, industry and the like. Certainly this is as true in securities law as in antitrust, patent, trademark, copyright and other fields. But one may not gain such advantage by conduct constituting secreting, stealing, purloining or otherwise misappropriating material nonpublic information in breach of an employer-imposed fiduciary duty of confidentiality. Such conduct constitutes chicanery, not competition; foul play, not fair play. Indeed, underlying section 10(b) and the major securities laws generally is the fundamental promotion of " 'the highest ethical standards . . .' in every facet of the securities industry." *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186-187 (1963) (quoting *Silver v. New York Stock Exchange*, 373 U.S. 341, 366 (1963)), *cited approvingly in Eichler*, 105 S. Ct. at 2631. We think the broad language and important objectives of section 10(b) and Rule 10b-5 render appellants' conduct herein unlawful, as in *Newman* and *Materia*. *See also*, *In re Investors Management Co.*, 44 S.E.C. 633, 641 n.18 (1971) (SEC stating that Rule 10b-5 extends to trading based upon

"information . . . obtained by industrial espionage, commercial bribery or the like").

We do not think that the "fraud and deceit" in this case significantly differ from the "fraud and deceit" in *Newman* and *Materia*. Winans "misappropriated—stole, to put it bluntly—valuable nonpublic information entrusted to him in the utmost confidence." *Chiarella*, 445 U.S. at 245 (Burger, C.J., dissenting), *quoted in Materia*, 745 F.2d at 201. The information misappropriated here was the *Journal's* own confidential schedule of forthcoming publications. It was the advance knowledge of the timing and content of these publications, upon which appellants, acting secretively, reasonably expected to and did realize profits in securities transactions.[8] Since section 10(b) has been found to proscribe fraudulent trading by insiders or outsiders, such conduct constituted fraud and deceit, as it would had Winans stolen material nonpublic information from traditional corporate insiders or quasi-

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[8] We cannot agree with the conclusion drawn from the view expressed by our brother, Judge Miner, in his dissenting opinion, that the prepublication schedules were not "secrets to which Winans always was privy, since he frequently did not know which writings would be published, when they would be published or even if they would be published." In our view, that statement exalts the exception over the rule. The district court found that between October 1983 and the end of February 1984, twenty-seven "Heard" columns were leaked in advance. 623 F. Supp. at 833. If an occasional investment plan faltered due to nonpublication of the anticipated corollary "Heard" column, the record nonetheless amply demonstrates that the majority of the securities traded resulted in profits reflecting the predictable price change due to the publication anticipated. This was true, for example, of trades in American Surgery Centers, Institutional Investors, and TIE/Communications, Inc., to mention just a few of the securities traded. In any event, a fraudulent scheme need not be foolproof to constitute a violation of Rule 10b-5. It is enough that appellants reasonably expected to and generally did reap profits by trading on the basis of material, nonpublic information misappropriated from the *Journal* by an employee who owed a duty of confidentiality to the *Journal*.

insiders. *See Materia*, 745 F.2d at 201-03. Felis' liability as a tippee derives from Winans' liability given the district court's finding of the requisite scienter on Felis' part. *See Ernst & Ernst*, 425 U.S. 185.

Nor is there any doubt that this "fraud and deceit" was perpetrated "upon a[ny] person" under section 10(b) and Rule 10b-5. It is sufficient that the fraud was committed upon Winans' employer. *See Materia*, 745 F.2d at 202 (printing press employee liable for fraud upon employer); *Newman*, 664 F.2d at 17 (investment banking employees liable principally for "sullying the reputations" of their employers); *Musella*, 578 F. Supp. at 438 (office manager liable for sullying reputation of law firm). Appellants Winans, and Felis and Carpenter by their complicity, perpetrated their fraud "upon" the *Wall Street Journal*, sullying its reputation and thereby defrauding it "as surely as if they took [its] money." *Newman*, 664 F.2d at 17.

As to the "in connection with" standard, the use of the misappropriated information for the financial benefit of the defendants and to the financial detriment of those investors with whom appellants traded supports the conclusion that appellants' fraud was "in connection with" the purchase or sale of securities under section 10(b) and Rule 10b-5. We can deduce reasonably that those who purchased or sold securities without the misappropriated information would not have purchased or sold, at least at the transaction prices, had they had the benefit of that information. *See, e.g., Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974). Certainly the protection of investors is the major purpose of section 10(b) and Rule 10b-5. *Id.* at 235. Further,

investors are endangered equally by fraud by non-inside misappropriators as by fraud by insiders.[9]

Appellants correctly point out that "not every instance of financial unfairness constitutes fraudulent activity under Section 10(b)," *Chiarella*, 445 U.S. at 232; that the "misappropriation theory" requires a nexus between the duty and the federal securities regulatory scheme, *id.* at 222; *Newman*, 664 F.2d at 12; *Materia*, 745 F.2d at 197. Here, however, the misappropriated information regarding the timing and content of certain *Journal* columns had "no value whatsoever [to appellants] except 'in connection with' [their] subsequent purchase[s] [and sales] of securities." *Materia*, 745 F.2d at 203. The "sole purpose" of the scheme was to purchase and sell securities, *see*

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9 We disagree with the view expressed by Judge Miner in his dissenting opinion that no "securities-related" information was purloined. For purposes of Rule 10b-5, an omission (or a misstatement) may be considered "material" if the information omitted (or misstated) "in reasonable and objective contemplation might affect the value of the corporation stock or securities . . . ." *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 849 (2d Cir. 1968) (Waterman, J.) (quoting *Kohler v. Kohler Co.*, 319 F.2d 634, 642 (7th Cir. 1963)), *cert. denied*, 394 U.S. 976 (1969). *See also Radiation Dynamics v. Goldmuntz*, 464 F.2d 876, 888 (2d Cir. 1972) (approving materiality instruction substantially following language in *Texas Gulf Sulphur*); *cf. TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (holding omission material "if there is a substantial likelihood that a reasonable shareholder would consider it important"). In our view, the satisfaction of this standard, even narrowly defined, is beyond question, given that the "Heard" columns had undisputed significant market impact; that after the first attempt at profits Winans and Felis recognized that profits woud be reaped if trades were made on the basis of analyses of *particular* securities (rather than of general industries) to be published in forthcoming columns, *see* 612 F. Supp. at 833; that generally, "transactions were closed on the same day as an article's publication, thereby maximizing its impact," *id.* at 834; and that, once the mature scheme was in operation, net profits therefrom approached $690,000 over several months. *Id.* Indeed, the prices of the twenty-nine stocks traded often changed significantly, sometimes even dramatically, between the closing prices the day before publications and the opening prices at 10:00 a.m. on the day of publications.

Newman, 664 F.2d at 18; *see also Jannes v. Microwave Communications, Inc.*, 461 F.2d 525, 528-30 (7th Cir. 1972), and thereby virtually to "reap instant no-risk profits in the stock market." *Materia*, 745 F.2d at 203. Indeed, given the breadth of the "in connection with" standard, *see, e.g., Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Competitive Associates, Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 815 (2d Cir. 1975), appellants' argument to the contrary seems frivolous.

Appellants argue that it is anomalous to hold an employee liable for acts that his employer could lawfully commit. Admittedly, the employers in *Newman* were investment banks that would be barred by federal securities laws from trading in securities of their clients, while in the present case the *Wall Street Journal* or its parent, Dow Jones Company, might perhaps lawfully disregard its own confidentiality policy by trading in the stock of companies to be discussed in forthcoming articles.[10] But a reputable newspaper, even if it could lawfully do so, would be unlikely to undermine its own valued asset, its reputation, which it surely would do by trading on the basis of its knowledge of forthcoming publications. *See* Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 Hofstra L. Rev. 9, 43 (1984). Although the employer may perhaps lawfully destroy its own reputation, its employees should be and are barred from destroying their employer's reputation by

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10 We express no view as to whether trading by a newspaper on the basis of material, nonpublic prepublication information would constitute a securities violation as, *e.g.*, a "manipulative device" under section 10(b); or as unlawful touting under section 17 of the Securities Act of 1933, 15 U.S.C. § 77q (1933), *see* 3 L. Loss, Securities Regulation 1518-19 (1961); or under any other theory.

misappropriating their employer's informational property. Appellants' argument that this distinction would be unfair to employees illogically casts the thief and the victim in the same shoes.[11] A more apt analogy might be drawn between the employee-employer distinction herein and the fiduciary-corporate client distinction in *Newman*, *Materia*, and *Musella*. In these cases, the misappropriation theory prohibited, respectively, an investment bank, a financial printer, or a law firm, from trading on the material, nonpublic information of its corporate client, which itself presumably remained free to trade in its own securities, absent other contrary rules in the securities laws, such as the Williams Act five percent rule, 15 U.S.C. §§ 78m(d), 78n(d). Here, appellants, constrained by the employer's confidentiality policy, could not lawfully trade by fraudulently violating that policy, even if the *Journal*, the employer imposing the policy, might not be said to defraud itself should it make its own trades.

Thus, because of his duty of confidentiality to the *Journal*, defendant Winans—and Felis and Carpenter, who knowingly participated with him—had a corollary duty, which they breached, under section 10(b) and Rule 10b-5, to abstain from trading in securities on the basis of

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11 Indeed, theft or embezzlement of certain information is a statutory crime in some states. *See, e.g.*, N.Y. Pen. L. § 165.07 (McKinney's 1975) (unlawful use of secret scientific information); Mass. Gen. Laws, Chap. 266, § 30(4) (1985 Supp.) (theft of secret scientific material). Further, the victim of such theft or embezzlement may have a common law action for conversion against the misappropriator. See note 5, *supra*. Indeed, an employee's conversion may serve as the predicate for a securities violation. *Cf. Diamond v. Oreamuno*, 24 N.Y.2d 494, 503, 301 N.Y.S.2d 78, 85 (1969) (Fuld, Ch. J.) (permitting action alleging violation of section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b), and section 10(b) if such action is brought by individual purchaser, in pertinent part based on directors' alleged breach of duty of confidentiality to corporation).

the misappropriated information or to do so only upon making adequate disclosure to those with whom they traded.

The district court properly found that defendants had adequate notice of the illegality of their scheme. *See Newman*, 664 F.2d at 19 (citing *United States v. Persky*, 520 F.2d 283, 288 (2d Cir. 1975)). Certainly appellants herein had fair notice from *Chiarella*, *Newman*, and the decision of the district court in *Materia* that their conduct might violate section 10(b). Although appellants argue that the misappropriation in their case, predicated on breach of a duty to the *Wall Street Journal* rather than to a quasi-insider corporate client, such as a printing company or an investment bank or a law firm, renders the previous cases distinguishable, they clearly treaded closely enough along proscribed lines for the district court to find that they had adequate notice of the illegality of their acts. *See United States v. Ingredient Technology Corp.*, 698 F.2d 88, 96 (2d Cir.), *cert. denied*, 462 U.S. 1131 (1983); *United States v. Bohonus*, 628 F.2d 1167, 1174 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980).

Finally, we do not agree with the position taken in the brief of *amici curiae* that the district court's decision portends First Amendment infringements. The confidentiality restrictions stem from the *Wall Street Journal* and Dow Jones company rules, not from any action by the government. Moreover, we cannot see how the convictions will chill free speech. If Winans had respected his employer's reasonable confidentiality policy, he would have had nothing to fear by publishing his "Heard" columns. Indeed, where a columnist uses his position to profit in transactions, at least one court has held that he may be compelled to disclose to his readers his potential

financial stake in the impact of his columns. *See Zweig v. The Hearst Corp.*, 521 F.2d 1129 (9th Cir.), *cert. denied*, 423 U.S. 1025 (1975).[12] The First Amendment generally empowers a journalist with no "special privilege" merely for the exercise of his craft, *see* Cox, *Foreword: Freedom of Expression in the Burger Court*, 94 Harv. L. Rev. 1, 51, 50-55 (1980), and the securities laws require of him, no less than of others, compliance therewith in the pursuit of his financial interests. In short, having failed to sustain their burden of persuasion that application of the securities laws infringed First Amendment rights, *see id.* at 52-53, either directly or through *amici*, appellants remain subject to section 10(b) as a rule of general applicability. *Cf. Zurcher v. Stanford Daily*, 436 U.S. 547, 566 (1978) (production of evidence in criminal investigation); *Branzburg v. Hayes*, 408 U.S. 665, 680 (1972) (same); *Associated Press v. United States*, 326 U.S. 1, 20 (1945) (antitrust laws).

II.

We need not dwell at length on appellants' convictions for violating federal mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343. *See* 612 F. Supp. at 843-47. It is clear that "confidential and nonpublic commercial information" may constitute fraudulently misappropriated "property" under the mail fraud statute. *See United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896 (1978); *United States v. Von Barta*,

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12 *But cf. Chiarella*, 445 U.S. at 231-35 (also a non-misappropriation case; subsequently holding no duty of disclosure to persons with whom defendant had no prior dealings and no agency or fiduciary relationship). Whether or not a columnist has a duty of disclosure to his readers under federal securities laws, we note that the court in *Zweig* held that he does without reference to the First Amendment.

635 F.2d 999, 1006 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981). Although not every breach of an employee's fiduciary duty to his employer constitutes mail or wire fraud, *id.* at 1002; *Newman*, 664 F.2d at 19, it is clear from *Von Barta* and *United States v. Bronston*, 658 F.2d 920 (2d Cir. 1981), *cert. denied*, 456 U.S. 915 (1982), that "the concealment by a fiduciary of material information which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to another is a violation of the [mail fraud] statute." *Newman*, 664 F.2d at 19 (quoting *Bronston*, 658 F.2d at 926). *See also United States v. Siegel*, 717 F.2d 9 (2d Cir. 1983). In the present case, the scheme to misappropriate material nonpublic information regarding the *Journal's* forthcoming publications in breach of the employee's duty of confidentiality to the *Journal* in connection with securities transactions met the requirements of the above cited cases and, as noted *supra*, threatened to harm the *Journal's* reputation for professionalism and integrity.

Appellants may not successfully claim that they did not "cause" the use of interstate mail and wire communications for purposes of 18 U.S.C. §§ 1841 or 1843. It is sufficient that appellants knew that the use of interstate mail and wire services was a reasonably foreseeable consequence of the scheme. *Pereira v. United States*, 347 U.S. 1, 8-9 (1954); *United States v. Muni*, 668 F.2d 87 (2d Cir. 1981). Certainly appellants understood that the interstate mailings and wirings associated with the publication and distribution of the *Wall Street Journal* was "a normal and customary part" of that business. *Muni*, 668 F.2d at 90. Although the mailings and wirings did not result from the fraud itself, we agree with the district court that their

foreseeability and centrality to the scheme were sufficient predicates to allow a conclusion that appellants violated the mail and wire fraud statutes. Indeed, the mailings and wirings in this case were considerably more important to this scheme than were the incidental telephone calls by merchandisers in *Muni* for authority to make credit card sales.

Regarding the requisite specific intent to defraud under the mail and wire fraud statutes, it is sufficient that the district court found that Winans and Felis intended to deceive and defraud the *Journal*, and that Carpenter knowingly aided and abetted Winans and Felis in that effort. *See United States v. Gregg*, 612 F.2d 43, 50 (2d Cir. 1979) ("knowledge of and desire to assist the criminal activity of the principal and intent to injure or defraud" held sufficient).

III.

Appellants individually and collectively also make some collateral arguments, which we address in pertinent part below. Carpenter argues that his acquittal on the conspiracy charge is inconsistent with his conviction for aiding and abetting. The two crimes involve distinct standards of proof: the former requires "proof of a conspiratorial agreement," while the latter requires proof merely that a defendant "in some way associate himself with the venture, that he participate in it . . . [and] that he seek by his action to make it succeed." *United States v. Bommarito*, 524 F.2d 140, 145 (2d Cir. 1975); *see also United States v. Jackson*, 778 F.2d 933, 940 (2d Cir. 1985) (Friendly, J.) ("the offenses of conspiring and of aiding and abetting, while closely allied, are distinct"). We think that the district court properly applied these distinct

standards to, *inter alia*, Carpenter's knowledge of the scheme, his endorsement of checks, and his allowing Winans to trade in his name in the Merrill Lynch and Schwab accounts.

Nor are we persuaded that the evidence was insufficient to substantiate the district court's conclusions as to any of the counts, with one exception. We think the district court erred in holding Winans liable under counts 15, 20, and 23, to the extent that those counts involved Felis' trades on behalf of Felis' friend, Stephen Spratt. The district court found that "Felis used the information obtained from Winans beyond the scope of the original agreement." 612 F. Supp. at 835. The record evidence supports the conclusion that Winans' trading agreement with Felis was limited to specific persons. Winans, therefore, may not be found liable as to Felis' trades with or on behalf of Spratt, as to whom Winans had no agreement or knowledge. *Pinkerton v. United States*, 328 U.S. 640 (1946). However, we emphasize that Winans might have been liable for the Spratt trades had the scope of the trading agreement been broader, to include trading by or for persons other than the small group of conspirators herein, *see Pinkerton*, 328 U.S. at 646-47 (liability for acts of co-conspirator "in furtherance of the conspiracy"), or had the trades been "part of the ramifications of the plan which could . . . be reasonably forseen as a necessary or natural consequence of the unlawful agreement," *id.* at 648, or perhaps had Winans at least known of the Felis-Spratt relationship, *see United States v. Bennett*, 665 F.2d 16, 20 n.4 (2d Cir. 1981) (government "need prove only that the defendant was a member of the conspiracy and that the illegal acts lay within the scope of the conspiracy and were a foreseeable consequence of

it"). We further note that the Spratt counts were among the counts on which Winans received a sentence of concurrent probationary terms.

IV.

We conclude where we left off in *Materia*, that "[f]or all intents and purposes," the liability of Carpenter, Winans and Felis "was settled fifty years ago." *Materia*, 745 F.2d at 203. Congress' enactment in 1934 of a "comprehensive yet open-ended statutory scheme, capable of ongoing adaptation and refinement," *id.*, proscribes the misappropriation and deception that appellants perpetrated herein. To hold otherwise would undermine Congress' ideal in 1934 of "an open and honest market," *id.*, in which superior knowledge in the securities markets would be achieved honestly, fairly, and without resort to pernicious conduct.

Winans' conviction for conspiracy involving the Spratt trades is reversed. In all other respects, the judgment of the district court is affirmed.

MINER, *Circuit Judge*, dissenting in part:

Since I am of the opinion that the misappropriation theory cannot be interpreted so expansively as to encompass the activities of these defendants, I respectfully dissent from so much of the majority opinion as affirms the convictions for securities fraud.

Until today, the misappropriation theory of criminal liability for securities fraud was applied only in those

cases involving the taking and use of non-public, confidential, *securities-related* information by those who obtain that information through special relationships with their sources of knowledge. *S.E.C. v. Materia*, 745 F.2d 197 (2d Cir. 1984) (employee of printing establishment traded in securities on the basis of confidential takeover-target data stolen from his employer), *cert. denied*, 105 S. Ct. 2112 (1985); *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981) (employees of investment banks purchased securities on the strength of misappropriated confidential merger and acquisition information entrusted to the banks by corporate clients), *aff'd after remand*, 722 F.2d 729, *cert. denied*, 464 U.S. 863 (1983); *S.E.C. v. Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984) (manager of office services for law firm improperly acquired tender offer information and traded on it in violation of fiduciary duty to firm and its clients). "[T]he theory premises liability on a party's deception of those who have given him privileged access to confidential information." Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101, 124 (1984).

No confidential securities information imparted by reason of any special relationship was purloined by these defendants. The "Heard" columns written by Winans consisted of high quality, accurate articles dealing with the strengths and weaknesses of various securities, and the research data upon which the columns were based were fully available to the public. To say that the "publication schedule" of the Wall Street Journal was the non-public, confidential information stolen by the defendants is to extend the sweep of section 10(b) and rule 10b-5 beyond all reasonable bounds. Knowledge of publi-

cation dates simply is not the special securities-related knowledg implicated in the misappropriation theory. Moreover, it cannot be said that the schedules were secrets to which Winans always was privy, since he frequently did not know which writings would be published, when they would be published or even if they would be published.

While the proscription of fraudulent and deceptive practices in connection with the purchase and sale of securities is a broad one, it never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper. *Cf. A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 396 (2d Cir. 1967) (section 10(b) and rule 10b-5 were "designed to protect both investors and 'the public interest' "). It seems especially ludicrous for the government to contend that the court should enforce the Wall Street Journal's conflict of interest policy prohibiting employees from trading on the basis of pre-publication information while conceding that the Journal itself is not prohibited from trading on such information. Harm to reputation, rather than to securities markets or market participants, never has been recognized as a proper subject for redress under section 10(b) or rule 10b-5.

In sum, I do not believe that the securities fraud provisions were designed to prohibit the type of fraudulent conduct engaged in by these defendants. Such conduct is addressed adequately by the statutes establishing the mail and wire fraud offenses of which the defendants stand convicted. Under those statutes, it is sufficient for the imposition of criminal liability that an employee has failed to disclose to his employer *any material information* he is under a fiduciary duty to disclose. *Newman*, 664, F.2d at 19; *United States v. Bronston*, 658 F.2d 920 (2d Cir. 1981).

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 17th day of July one thousand nine hundred and eighty-six

Docket No. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

Appellee,

-v-

DAVID CARPENTER, KENNETH P. FELIS and R. FOSTER WINANS

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellant - **DAVID CARPENTER**

Upon consideration by the panel that heard the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 17th day of July one thousand nine hundred and eighty-six

Docket No. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

Appellee,

-v-

DAVID CARPENTER, KENNETH P. FELIS and R. FOSTER WINANS

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellant - **KENNETH P. FELIS**

Upon consideration by the panel that heard the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
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UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

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Docket No. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

- Appellee,

-v-

DAVID CARPENTER, KENNETH P. FELIS and R. FOSTER WINANS

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellant - **R. FOSTER WINANS**

Upon consideration by the panel that heard the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk

UNITED STATES of America

v.

R. Foster WINANS, David Carpenter and Kenneth P. Felis, Defendants.

No. SS 84 Cr. 605 (CES).

United States District Court,
S.D. New York.

June 24, 1985.

As Amended July 24, 1985.

William M. Tendy, Acting U.S. Atty., S.D.N.Y. by Peter J. Romatowski, New York City, for plaintiff.

Buchwald & Kaufman by Don D. Buchwald, New York City, for defendant Winans.

Mudge Rose, Guthrie, Alexander & Ferdon by Jed S. Rakoff, Howard W. Goldstein, Caroline A. Riggio, New York City for defendant Carpenter.

Brown, Wood, Ivey, Mitchell & Petty by E. Michael Bradley and I. Scott Bieler, New York City, for defendant Felis.

OPINION

STEWART, District Judge:

Defendants R. Foster Winans ("Winans"), David Carpenter ("Carpenter") and Kenneth P. Felis ("Felis") are charged in Counts Two through Sixty-One with participating in a scheme to trade in securities based on information misappropriated from the Wall Street Journal ("WSJ" or "the Journal"). The information allegedly stolen from the Journal was the timing, content and tenor of market-sensitive stories scheduled to appear in the paper. This conduct was allegedly in breach of a fiduciary duty owed to Winans' employer, Dow Jones & Co., the parent company of the Wall Street Journal. As such, Dow Jones was allegedly defrauded, and the indictment charges that these activities were in violation of

Sections 10(b) and 32 of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78ff and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5, and the mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343. All three defendants are also charged in Count One with conspiracy to violate those statutes and to obstruct justice by their agreement to cover up and obstruct any investigation of the scheme by disguising payments, by making false statements to Kidder Peabody, the WSJ and officers of the SEC, and by preparing false documents intended for submission to the SEC. Peter Brant, not a defendant in this action, is also named as a conspirator.[1]

Winans was a reporter at the Wall Street Journal, and one of the writers of the "Heard on the Street" column ("the *Heard* column"). Winans and Carpenter are homosexuals who have been involved in what they describe as a "spousal relationship" for over ten years. Carpenter also worked at the Wall Street Journal, but for a briefer period of time than Winans. Felis was a stockbroker at Kidder Peabody, who was brought into that brokerage firm by Peter Brant, the government's key witness in this prosecution. It is fair to say that Winans and Brant were the chief architects of this trading arrangement.

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1. Brant pleaded guilty to an information in another action (84 Cr. 470) and in connection therewith entered into a plea agreement requiring his testimony in this prosecution. After the trial concluded, the government disclosed some additional evidence concerning the accounts of two of Brant's clients, Roger Wilson and David Clark. As indicated at the hearing on June 13, 1985, these new matters, summarized in the government's letter of June 10, 1985, have been considered in connection with Brant's credibility.

I

After a twenty-day trial, we find the facts as follows. Winans was originally hired by the Dow Jones News Service in late March 1981. Referred by Winans, David Carpenter was hired by Dow Jones as a news clerk in December of 1981. Beginning on February 2, 1981, it was the practice of the Journal to distribute to all new employees "The Inside Story," a forty-four-page pamphlet with seven pages devoted to the conflicts of interest policy. Winans denied ever receiving this booklet, or any other written conflicts policy, although he testified to receiving benefits information at the time of hire; "The Inside Story" does contain data on benefits, but Winans testified that the form of benefits information he received was distinct from this particular pamphlet. As for Carpenter, who worked at the Wall Street Journal for approximately one and a half years, the government offers the same general practice testimony. However, Ms. Malloy, Personnel Manager for the New York region of Dow Jones, could not recall if she followed that practice with Carpenter, even though she was the one who conducted his orientation.

Winans received a promotion in the summer of 1982 when he became one of two full-time "Heard on the Street" writers. This column, the focus of the case, is a daily market gossip feature, which highlights a stock or group of stocks and analyzes notable volumes of trading or price movements occurring in the market. The *Heard* column reports both negative and positive information about its featured stocks, but also takes a point of view with respect to investment in the stocks that it reviews. Numerous witnesses, including Winans, testified that t column has an effect on the price of stocks mentioned in the column.[2] Testimony was presented by the defendants concerning the investment thesis of each column at issue in an attempt to show that price movements were related to factors other than the column's publication. We find that the *Heard* column does have an impact on the market, difficult though it may be to

2. There is no claim that the column generally, or that any column in particular, contained corporate inside information or any hold for release material.

quantify in any particular case. It is certainly obvious that the defendants believed that the column had such an impact.

The Dow Jones Conflicts of Interest Policy is a three and one-half-page statement. It covers a number of subjects and specifically forbids the purchase or sale of securities on the basis of articles an employee knows will appear in the newspaper; it also states that employees should not disclose the paper's future contents to anyone outside the company. The policy also states that "all material gleaned by you in the course of your work for Dow Jones is deemed to be strictly the Company's property." Winans denied knowledge of any conflicts of interest policy, written or verbally conveyed, although he admitted that maintaining the confidentiality of the contents and timing of the columns was a "practice" of which he was aware.

Stewart Pinkerton, the New York Bureau Manager at the time of Winans' hire, testified to a conversation in which he told Winans of the confidential and sensitive nature of the *Heard* column, as well as the essentials of the conflicts of interest policy. Winans testified that this meeting was a brief "welcome aboard" talk, in which he and Pinkerton discussed salary and exchanged platitudes. Richard Rustin, who was Assistant Chief of the New York bureau and Winans' supervisor on the *Heard* column, testified that he too told Winans of the sensitivity of the column, and the importance of not investing in stocks the writer is covering. He also cautioned Winans that he should not let sources know what would be appearing in the column. Both Pinkerton and Rustin testified to follow-up reminders about the confidentiality of the column, after hearing rumors of leaks or having overheard Winans speak inappropriately to sources. Winans denies these conversations as well.

Seven months after Winans started to write the *Heard* column, on April 14, 1983, Pinkerton wrote Winans, summarizing a job performance discussion about errors in Winans' columns. Pinkerton wrote:

> As you were made aware last August when you were hired to do the Heard on the Street Column, it's one of the most important columns we run. People rely on its insight, accuracy and integrity. When trust begins to erode on anything the

> Journal does, it creates grave concern, but especially so with something as sensitive as the Heard column.

Moreover, shortly after Winans' move to the *Heard* column, on August 19, 1982, he wrote Pinkerton a letter disclosing his free-lance activities and his plans to withdraw from them. Both these documents support Pinkerton's testimony that he and Winans had a substantive discussion about the ethical responsibilities associated with the *Heard* column and conflicts of interest in general.

We find that Winans had actual knowledge of the policy with respect to maintaining the confidentiality of the column. His testimony carefully used the word "practice" as opposed to "policy," but the factual distinction is meaningless. Winans knew he would be fired if his conduct came to light. He knew that part of his job responsibilities were to keep the subject matter and the publication date of the column secret. He discussed the topic with his co-writer, Gary Putka, and cautioned a new writer, Ed Leefeldt, not to be too obvious about the column's subject when dealing with sources. Winans also knew that he was supposed to tell his editors if he heard that word was out about a column's topic. He told his editors about one leak prior to his arrangement with Brant. Even during the course of the scheme, while deliberately tipping to Brant, he went to his editor to say that a source was aware that they were working on a certain column. On neither occasion did the editor choose to kill the column, but Winans knew that it was part of his job to allow his employer that option.

Defendants argue that there is a legal significance to a distinction between the violation of a policy and the failure to adhere to a practice. The legal argument will be addressed below, but we believe it is unnecessary for us to make the fine, factual distinctions between knowledge of a policy and knowledge of a practice that the defendants would have us make. In any event, we accept the testimony of Pinkerton and Rustin. We also find incredible Winans denial that he ever received the conflicts of interest policy statements.

As for David Carpenter, the government argues that he too knew of the policy from his work as a news assistant on the

national news desk. According to the testimony of Nancy Cardwell, the Night News Editor who supervised him at the time, part of Carpenter's job was to answer the phones. She testified that in performing that task, he often had to deflect callers who sought to learn about the appearance of an article. Sometime in January of 1983, Carpenter asked Cardwell how to look up the stock symbol for American Surgery; he said "that's my stock" and over the next few weeks, she noticed he would frequently check the price. She believes at some point he commented, "Foster likes that stock," but for all she knew, that meant Winans had written a column about it and he had read it. We find that Carpenter was aware generally of the policy.

The American Surgery investment is the first overt act alleged in the conspiracy count, although it is not charged as a substantive crime. In early January of 1983, Winans started looking into the company in connection with a possible article. On January 10 or 11 he purchased American Surgery stock for a brokerage account held in David Carpenter's name, at a total cost of $1,814.17. Two favorable *Heard* columns were written about the company and published on January 13, 1983 and March 23, 1983; the 400 shares of stock were sold on May 17, 1983 for $4,673.64. Similarly, he bought 1,000 shares of Institutional Investors stock in Carpenter's account on April 28, 1983, and a favorable article appeared on June 1, 1983; the Institutional Investors stock was sold five days later. A $497.59 profit was made on the initial $1,237.50 investment in Institutional Investors.

The government seeks to use the early trades in American Surgery and Institutional Investors as the beginning stages of the conspiracy, which Brant and Felis joined later, providing the know-how in securities trading and large-scale capital. While we are not persuaded by Winans' testimony that these purchases and sales were investment decisions entirely independent of the WSJ articles, we do not believe that any conspiratorial agreement existed at this time between Winans and Carpenter. The account at Merrill Lynch and the subsequent account at Charles Schwab & Co., Inc. (in which these trades were made) were in Carpenter's name, but Carpenter's involvement in the trading decisions was minimal. Winans filled out the applications for the accounts, and either told Carpenter what trades to make or

made them himself, identifying himself as Carpenter over the phone. Although Winans was keenly aware of the impropriety of the trading, we cannot accept the government's view of this trading as pursuant to a conspiracy between him and Carpenter.

American Surgery remains significant in that it indirectly led Winans to Peter Brant, when Mark Delotte, a public relations consultant for that company, put the two in touch. Delotte suggested Brant as a possible focus of an article about superbrokers. Brant was the number one broker at Kidder Peabody, with a commission income of $1.8 million for the fiscal year December 1982 through November 1983. Brant and Winans met for the first time in mid-May of 1983. While Brant was not enthusiastic about a possible article featuring him, they met again on June 1, 1983 to tour the Racquet Club and have dinner at "21". A third meeting on June 14 was intended to be an opportunity for Winans to observe Brant meeting with a new client, but the potential client cancelled; instead, the meeting was another general chat about investing philosophies and lifestyles. At all of these initial meetings, the discussion related to Brant's phenomenal market success, his personal wealth and flamboyant lifestyle.

From June of 1983 on, Brant became one of Winans' regular sources. He was quoted in an August 31, 1983 article, and quoted again, but not identified, in a September 2 column. Brant also invited Winans to a July 4th party on his boat, but Winans declined.

Brant and Winans present conflicting stories with respect to the birth of the scheme. Both testified to an October 12 meeting at the Racquet Club. According to Brant, nothing particularly significant took place that day, although there had been previous conversations in which he remarked to Winans about the coincidence of his own trading in two stocks, Apple Computer and Widergren, which later became subjects of *Heard* columns. Winans testified expansively to a meeting in which Brant turned the topic of conversation away from the broker and on to the reporter; they talked about Winans' work, career goals and financial situation. Winans testified that Brant brought up the coincidental trading in Apple more pointedly.

According to Winans, Brant directly said, "You know, if I knew beforehand what was going to be in the column, we could make a lot of money." Winans testified that although the statement was made lightly, there was no doubt in his mind that Brant was not joking, but was making an offer. Brant denies this entirely.

This conflict in the testimony need not be resolved, since it is undisputed that the next weekend, Winans went out to Brant's house, and the two struck a deal on Sunday, October 16, 1983, on the Meadowbrook golf course on Long Island. They agreed that Winans would leak information to Brant with respect to the timing, subject and tenor of *Heard* columns so that Brant could trade in securities armed with that information. Both testified that it was part of the agreement that the arrangement would not affect the journalistic purity of Winans' writing. On Winans' side, the agreement would not influence his choice of topic or the contents of any article; he would continue to write balanced pieces, containing both negative and positive information. Brant was told that occasionally columns were killed or delayed because of a superseding newsworthy item. On Brant's end, the timing, volume and type of trading was totally in his hands. As for the distribution of profits, it seems to have been assumed that net profits were to be split after fifty percent was set aside for taxes. It also appears to have been assumed that Winans would receive nothing if there were no profits.

Brant states that Winans described Carpenter as someone he was close to, who would know of the arrangement. In response, Brant asked if Carpenter could be trusted; Winans assured him on this point. Winans testified that his reference to Carpenter was intended to let Brant know that he was a homosexual as well as to see if there was any possibility of a part-time job for Carpenter. Brant says that he told Winans about Felis at that time, describing him as a business partner who would also participate; Winans testified that Brant told him about Felis a day or two later over the phone. Lastly, it was agreed that Brant would advance Winans $15,000, and that the check should be made out to Carpenter to avoid using Winans' name.

On that Sunday afternoon, Brant called Felis to tell him of the arrangement; Brant testified that Felis was enthusiastic.

Winans went home and told Carpenter that he was going to be giving Brant stock ideas he picked up in his work and Brant would be giving him money. Carpenter's SEC testimony similarly reflects that, at first, Carpenter only knew of a business arrangement between Brant and Winans in the most general sense.

The following week, the agreement was put into effect. The advance from Brant was delivered to Winans; the $15,000 check was tucked inside a Kidder Peabody research report. Carpenter endorsed the check, and Winans deposited it the following day in their joint checking account. That Monday, October 17, 1983, Winans leaked to Brant that the *Heard* column for Tuesday was to be a positive column on oil drilling stocks. Stock and options in Schlumberger, Ltd., one of a number of companies mentioned, were bought in two accounts, one in Brant's name and a second in Felis' name, the latter jointly owned by Brant and Felis. The scheme began inauspiciously, when a more newsworthy article came up, and the oil drilling column was displaced and delayed by a day. The first trade resulted in a loss of $37,914.25 in Felis' account and $9,550.53 in Brant's account.

On October 18, 1983, Brant included David W.C. Clark, a client and friend, in the deal. Brant testified at trial that Clark was depressed and suicidal one night, and Brant told him of the plan and its profit potential in order to cheer him up. Felis' reaction to this addition was to state that "Clark is a pig and he'll get us all caught." Brant traded on information from Winans in Clark's accounts at Kidder Peabody beginning on October 19, 1983 despite this lack of enthusiasm. Winans was never aware of this trading, which is not included in any of the substantive counts; Winans only learned of Clark's existence at the time the SEC started asking questions.

The second trade was in TIE/Communications, Inc., and resulted in a profit of over $100,000 in the Felis and Clark accounts. On October 20, 1983, Winans, Brant and Felis met for drinks at the Racquet Club and went out to dinner. The group discussed that there was a better profit potential in columns focusing on one stock, such as the column on TIE, rather than a column about a group of stocks, such as the mention of

Schlumberger as one of a number of oil drilling companies. Felis suggested a flat fee of $25,000 per story for Winans. There was also some discussion about being careful not to attract attention.

The following weekend was spent at Brant's home again, with Carpenter accompanying Winans on this occasion. Apparently little business conversation took place, and Brant recalled none. In contrast to Brant's lack of recall, Winans and Carpenter testified to a conversation on the same golf course, but both Winans, at trial, and Carpenter, in his SEC testimony, described it as a general discussion about stocks and making a lot of money.

From this point in October until the end of February 1984, approximately twenty-seven articles were leaked in advance, not all of which were written by Winans. When the topic was set for the next day, Winans would call Brant. Winans could only recall one specific instance in which he called Felis, in connection with a story on Chicago-Milwaukee, although he thought that he may have called Felis additional times. His calls were generally made from a pay phone outside the WSJ building. He also used the name "Howard Cohen," or variations thereof, when calling Brant. Apparently, he was not very good at remembering his false name and sometimes identified himself as Howard Kahn or Howard Winans.

The execution of the trades was entirely left to Brant, who testified that he would discuss the strategy with Felis and/or Clark. Depending on the positive or negative tone of the article, stock was either bought or sold short, and call or put options were either bought or sold. Most often, the transactions were closed on the same day as an article's publication, thereby maximizing its impact. The net profits amounted to almost $690,000, taking into account trading in all the accounts connected with the defendants.[3]

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3. These accounts were in the following names: Clark, Felis, Carpenter, Winans, Western Hemisphere, Spratt and Brant.

The distribution of profits was far from mathematically exact; it may be a coincidence that the $30,000 paid to Winans actually does reflect a one-third share of the after-tax profits from the Felis and Western Hemisphere accounts. Brant would generally inform Winans about making money on trades, but Winans does not appear to have been keeping careful track. He asked for money when he needed it. On November 10, 1983, Brant gave Winans 750 British pounds for Carpenter to use on his trip to London. On December 7, in response to another request from Winans in connection with a specific need, Brant wrote a check for $5,000. The last payment was a $10,000 check issued on January 26, 1984.

The $10,000 check written on January 26, 1984 has the handwritten notation "drapes" on it. Brant asked Felis to write the check. Since it was the first check Felis made out for Winans, he asked "What should I write on this thing, drapes?", to which Brant responded "Yes." While Brant initially testified that this justification for the payments had been previously discussed at his house, in a conversation between Felis, Carpenter and himself, he ultimately backtracked and equivocated, admitting that any such conversation that included both Carpenter and Felis might have taken place after the check was drawn; Brant did state that it was definitely discussed at a February 11, 1984 meeting. However, testimony from Gary Lickle, Brant's friend and attorney who was at the house that weekend, established that on February 11, Carpenter, Brant and Felis never had a private conversation. While this testimony is significant with regard to Carpenter, it means nothing with respect to Felis' knowledge at the time the check was written. He must have had some sort of conversation with Brant at the time he wrote the check, and it is irrelevant whether Brant told him to write the word "drapes" on the check or whether Felis brought it up. As Felis was aware, the check was not for decorating services; the addition of the word "drapes" was to establish a basis for saying that it was.

Nor do we understand defendant Felis' explanation that, in light of Brant's testimony that someone, maybe Carpenter, felt a need to have an explanation of how the payment should be declared as income for tax purposes, the worst this notation shows is a scheme to defraud the IRS. The fact remains that

Brant and Felis recognized that there was a problem with the true source of the income, necessitating a false explanation for the payment.

Felis, Brant and Winans met two other times in addition to the October 20 meeting: once at the Racquet Club followed by dinner at Cafe Seiyokin in late October or early November, and once at Brant's house the weekend of February 11, 1984. Carpenter, Brant and Winans met a total of three times: during the October 22 weekend, for drinks and dinner in November of 1983, and during the above-mentioned February 11 weekend accompanied by Felis as well. After the Cafe Seiyokin evening, Winans objected to further meetings at the Racquet Club for fear of running into Wall Street or Wall Street Journal acquaintances.

The government argues that during the agreement's operation, the contents of three of Winans' stories were affected by the conspiracy, in that Winans pushed for publication of articles on Todd Shipyards and Petro Lewis over the objections of his collegue, Gary Putka, who disagreed with the contents and tenor thereof. However, those two instances appear to be only examples of a routine difference of opinion between Winans and Putka. If anything, the fact that the government has the opportunity to make this argument points out the difficulty of maintaining a stance of journalistic purity when the reporter is engaged in a decidedly unpure venture.[4]

More troubling is Winans' testimony at the SEC with respect to his January 19, 1984 article on Digital Switch. Digital Switch was a stock that had helped to make Brant rich. He was heavily invested in the stock, and it was not doing well.

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4. Maintaining the journalistic purity of the column was actually consistent with the goals of the conspirators. As Winans testified, a particularly compelling column or a fresh investment thesis would have a significant impact on the price of the featured stock. As he stated, "The impact on the market told me the column was good." However, if false or slanted articles were published, the column's readers would very likely lose confidence in the column and cease to rely on it. As a result, its otherwise predictable impact on the market would be lost to the detriment of the conspirators and the possibility of discovery of the scheme by Winans' superiors would be enhanced.

Indeed, both the government and the defendants point to the poor market status of this stock as Brant's motive for entering into the arrangement. Winans unequivocally testified at the SEC that Brant's promise of a big distribution of profits if he could get out of Digital Switch was "an inducement" and a factor in his choosing to write the January 19 article. At trial, Winans testified that he was trying to be helpful at the SEC, that this was the only time that Brant had connected their agreement with a story idea, and that in his SEC testimony he misspoke. While Brant may have been offering an inducement, Winans testified that the inducement did not affect his journalistic judgment in choosing to write the article; it was a newsworthy column which was written for that reason. That may be the case, but we do not accept his rejection of his SEC testimony; rather, we accept it as evidence of Winans' criminal intent.

Trading by Winans also continued in Carpenter's Schwab account during the time in which Winans was profiting from Brant's trading. Six trades took place in the Carpenter account, each on the day before an article appeared in the Wall Street Journal. Like the earlier trading in American Surgery and Institutional Investors, Carpenter's role in this trading was primarily ministerial, although as indicated in his SEC testimony, he was aware that these purchases and sales were connected with the appearance of articles in the Journal.

Felis used the information obtained from Winans beyond the scope of the original agreement. The topic and tone of forthcoming *Heard* articles was passed by him in seven instances to Douglas McCaskey, a stockbroker and an old college friend of Felis. Similarly, Felis tipped Stephen Spratt, his junior partner in his Connecticut business in four instances. Spratt's broker noticed the correlation between Spratt's transaction and a WSJ article in one such trade. Spratt called Felis, who said "you better change your account." Felis, in an obvious effort to conceal the conspiratorial scheme, told him to move accounts because his broker would start copying his trades, and Spratt would not get good service. At trial, Spratt also testified that Felis told him that there was nothing wrong with the trading, that it was just one of Brant's tips, and that an attorney had said it was legal; Spratt made no mention of this latter part of the conversation when he testified before the SEC.

On November, 3, 1983, Kidder Peabody's Compliance Department noticed correlation between *Heard* articles and trading in the Felis and Clark accounts. William Kennedy, New York Regional Manager for Kidder Peabody, asked Brant and Felis about the trades. Felis falsely stated that he was merely copying the trades of Clark, who Brant asserted got his information from friends on Wall Street. Brant also falsely denied knowing anyone at the WSJ. Kennedy said that Felis' trading had to stop, and told Brant and Felis that he was going to seek legal advice with respect to Clark's unsolicited trades.

As a result of that meeting, Brant and Felis liquidated the Felis account and had a Kidder Peabody $275,000 check drawn to Morgan Guaranty. On November 4, 1983, the Kidder Peabody check was exchanged for a bank check payable to "Western Hemisphere Trade Corp. No. 2"; no transaction is reflected in Felis' account. Brant had already telephoned the Bank Institute of Zurich and made arrangements to open an account in the Western Hemisphere name in Switzerland.

Felis had already arranged a trip to Europe and opened the Swiss bank account in November while abroad. The Western Hemisphere Trade Corp. money was wired back to a new Kidder Peabody account, and trading on Winans' information continued, except now it was in the name of Western Hemisphere rather than in Felis' account at Kidder Peabody. Ultimately, the money from the Western Hemisphere account was split between Brant and Felis when the account was closed in March 1984.

After the November 3 meeting, Robert Krantz, the General Counsel of Kidder Peabody, asked the law firm of Sullivan & Cromwell for an opinion on the legality of Clark's trading. A preliminary memorandum was written at the law firm on the premise that Clark had an inside source at the WSJ. The memorandum concluded that Clark would be subject to criminal and SEC enforcement proceedings and might be subject to civil liability. Though the memorandum was a preliminary one, and the partner in charge at Sullivan & Cromwell was not entirely satisfied with it, Krantz went to see Clark (who is a lawyer) to stop the trading. He and Clark met on November 17, 1983, and he told Clark about Sullivan &

Cromwell's conclusions. Clark denied having any source at the WSJ. The upshot of the encounter was that Clark stated that Brant was not being very helpful, and that he intended to move his trading to another brokerage firm. In fact, he did open an account at Bear Stearns and continued to trade on Winans' information.

Krantz's next stop on that day was to see Brant to explain why he had just encouraged one of Brant's valuable clients to take his business elsewhere. Krantz described his intentions as "handholding." By the time he got there, Brant told him that Clark had already called to say he was going to discontinue his trading. At this meeting, which Felis joined, Krantz recalled telling Brant and Felis that he did not know if the trading was legal or illegal, but "he had begun to think that there was some type of violation involved here if the material was in fact coming from the WSJ." Krantz was not sure if he specifically said anything about the Sullivan & Cromwell memorandum and its conclusions. When Brant asked him if they had done anything wrong, Krantz responded that he did not think so, and that he was not sure that Clark had done anything wrong either in light of *Dirks v. SEC*, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983). However, the entire conversation was premised on the assumption that if anyone had a tie to the WSJ, it was Clark, and all Brant and Felis had done was execute unsolicited orders and copy the trades. Nor did Krantz have any idea that there was a systematic plan to advance information with a Wall Street Journal reporter sharing in the profits.

On March 1, 1984, the SEC, having commenced an investigation, called Clark, who promptly informed Brant, who then passed the word along to Felis. Clark gave false answers to the agency's questions about the trading; he told the investigators that he had several sources on Wall Street. He told Brant he had sent them "up some blind alley" by mentioning unconnected individuals and brokerage firms. Clark also told them he did not know Winans. On the same day, Winans was called into a Wall Street Journal executive office, where Mr. Pearlstine, Managing Editor of the Journal, and Robert Sack, counsel to the Journal, were also present. Although Winans was warned about the ramifications of giving false answers, he gave a number of patently untruthful responses to the SEC's questions.

Specifically, he denied having any interest in a brokerage account in someone else's name and denied having received any money from Peter Brant.

That night, Carpenter called Brant and said that "the drapes are not hanging right," a none too subtle reference to the $10,000 check written by Felis a little over a month earlier. Winans sent Carpenter to meet Brant with a note reflecting what had been asked by the SEC and what his responses had been. Winans testified that the use of a written narrative was not part of any surreptitious plan to get their stories straight, but a reflection of his own lack of faith in Carpenter's memory; we accept his testimony that he did not want to rely on Carpenter's memory, but we reject the balance of this testimony. He also testified that he did not want the notes left with Brant. Carpenter and Brant met at Brant's Manhattan apartment. Upon learning that Winans denied receiving any money from Brant, Brant remarked that it was a good thing that the checks had been written out to Carpenter. To his dismay, he learned for the first time that the checks had been deposited in Carpenter's and Winans' joint checking account. Carpenter tried to get information from Brant about some of the names that the SEC had questioned Winans about, specifically Clark, and Brant's response was evasive. It is also unclear whether it was at this or a subsequent meeting that the preparation of false invoices to justify the payments as decorating services was discussed.

Winans met with Dow Jones attorneys and executives on March 2, 1984. At this point, there was no suggestion that Winans was involved in any improper conduct, and Winans did not tell his employer the truth. Over the following weekend, Carpenter went to Brant's Long Island home with another written narrative of Winans' conversations. At this time, Winans was aware that the checks were to be justified by attributing them to payments for decorating services. He knew that Brant and Felis were putting pressure on Carpenter to prepare fake invoices to support that explanation.

Brant himself was contacted by the SEC on March 5, and he too did not tell the truth. A plan to go to Brazil with David Clark was made, but not carried out. In mid-March, Brant

went to Florida with his family. Meanwhile, Winans hung on at the Wall Street Journal. Although he testified that he was suicidal during this time period, Winans was actually engaged in pursuing a new job outside the Journal and was even haggling with his employer about severance pay in mid-March.

The SEC investigation became formal on March 14. On March 21, 1984, Brant, Felis and Carpenter had a lunch-time meeting in New York. There was further discussion about the invoices, with an instruction from Felis not to have them in sequential order in light of the lapse of time between checks. That same night Brant, Felis, Carpenter and Winans met at Trader Vics in the Plaza Hotel. Carpenter finally produced the invoices either that evening or sometime earlier that afternoon; these documents are clumsily executed and are unsigned and undated.

The Trader Vics meeting was highly emotional. Winans was only there for part of the time, and Brant reassured him that nothing would happen. Brant said that he could say that in the course of his conversations with Winans as a source, he figured out what Winans was working on; the payments to Carpenter were explainable as decorating expenses. Carpenter had been drinking and was slightly hysterical. After Winans left, Carpenter, Felis and Brant got into a fight. Carpenter made vague threats about backing from gay and journalistic organizations. Brant and Felis tried to calm him down and made similar vague threats about the necessity of sticking to the story.

According to Winans' SEC testimony, Winans and Carpenter no longer trusted Brant and Felis. On March 29, Winans and Carpenter voluntarily went to the SEC and testified fully about the scheme.

II

The conspiracy count alleges a scheme beginning on or about January 1, 1983 and running until March 29, 1984. The defendants are alleged to have conspired to commit securities fraud, mail fraud and wire fraud, and to obstruct the SEC investigation by engaging in a cover–up and by making false statements to Kidder Peabody, the WSJ and the SEC. The January date for the birth of the plan reflects the government's view that the conspiracy originated between Winans and Carpenter. The early trades in American Surgery and Institutional Investors are the first overt acts identified in the indictment.

It is well–settled that the crime of conspiracy is an illegal agreement among conspirators for which a "meeting of the minds" is required. *See generally United States v. Rosenblatt*, 554 F.2d 36, 38 (2d Cir. 1977). There must be agreement as to the "essential nature" of the plan, and a "general agreement to engage in unspecified criminal conduct is insufficient to identify the essential nature of the conspiratorial plan." *Id.* at 38–39. Mere presence at the scene of a crime or mere association with conspirators is not enough to show membership in a conspiracy. *United States v. Martino*, 759 F.2d 998 (2d Cir. 1985). There must be some evidence that the defendant "associat[ed] himself with the venture in some fashion, 'participate[ed] in it as something that he wish[ed] to bring about,' or, [sought] by his action to make it succeed.'" *United States v. Johnson*, 513 F.2d 819, 823 (2d Cir. 1975) (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938).

Counts Two through Twenty–Five charged that the defendants "unlawfully, wilfully and knowingly, directly and indirectly, and by use of means and instrumentalities of foreign and interstate commerce, the mails, and the facilities of national securities exchanges, did (a) employ devices, schemes and artifices to defraud, and (b) engage in acts, practices and courses of business, which operated as a fraud and deceit on the Wall Street Journal and Dow Jones & Company, Inc., in connection with the purchase and sale of securities" in violation of 15 U.S.C. §§ 78j(b), 78ff, and Rule 10b–5 promulgated thereunder. 17 C.F.R. § 240.10b–5. Each count relates to a

specific transaction, with the first trade in Schlumberger, Ltd. taking place on October 17, 1983.[5]

The prosecution's theory in support of these securities counts is known as the misappropriation of information theory, which had its genesis in *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980). Chiarella was a mark-up man at a financial printing firm. In the course of his employment, he deciphered the identity of companies targeted for takeovers or mergers, purchased stock in those companies and sold immediately after the plans became public, thereby making a substantial profit. Although his conviction was affirmed by the Second Circuit, the Supreme Court reversed, holding that Chiarella owed no duty to disclose his inside information to the sellers of the securities.

The Second Circuit had held that not only did Chiarella have such a duty to the sellers, but the Court also commented that he had breached a duty to his employer. In a footnote, the Court stated that the indictment

> not only alleged that appellant's activities "operated as fraud and deceit upon the sellers of the aforementioned securities," it also charged a "scheme to defraud" in general terms. Clearly, violation of an agent's duty to respect client confidences, Restatement (2d) Agency § 395, transgresses Rule 10b–5 where, as here, the converted information both concerned securities and was used to purchase and sell securities.

United States v. Chiarella, 588 F.2d 1358, 1368 n. 14 (2d Cir. 1978), *rev'd*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980). The Supreme Court refused to address the merits of the misappropriation theory on the ground that it had not been properly presented to the jury. *Chiarella, supra*, 445

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5. While Winans is named in all of the counts, Felis and Carpenter are not charged with each transaction. This is also true for the mail and wire fraud counts. With respect to the securities fraud counts, the government at the close of its case, dropped counts 19 and 25 charged against defendants Winans and Felis.

U.S. at 236–37, 100 S.Ct. at 1118–19. In a dissenting opinion, Justice Burger (who believed the issue was properly before the court) heartily endorsed the Second Circuit approach, arguing that securities fraud need not only be premised on a relationship between the buyer and seller:

> In particular, the rule should give way when an informational advantage is obtained, not by superior experience, foresight and industry, but by some unlawful means. . . . I would read §10(b) and Rule 10b–5 to encompass and build on this principle: to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading.

Id. at 240, 100 S. Ct. at 1121 (Burger, J. dissenting). Justice Brennan, concurring in the judgment, agreed with Justice Burger's presentation of the misappropriation theory, but thought it was not adequately charged. *Id.* at 239, 100 S.Ct. at 1120. Justices Blackmun and Marshall, dissenting, agreed generally with the Chief Justice's dissenting opinion, but thought that the theory was unnecessary to sustain the conviction. *Id.* at 245, 100 S.Ct. at 1123. The last hint of the Supreme Court's view of this alternative theory is found in Justice Stevens' concurrence, in which he remarks that "respectable arguments could be made" both in favor of and against the theory, but "[t]he Court wisely leaves the resolution of this issue to another day." *Id.* at 238, 100 S.Ct. at 1120.

October 31, 1981 was the day the Second Circuit cast its vote in favor of the theory in a case in which employees of investment banking firms "misappropriated confidential information concerning proposed mergers and acquisitions that was entrusted to their employers by corporate clients." *United States v. Newman*, 664 F.2d 12, 15 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, ___U.S.___, 104 S.Ct. 193, 78 L.Ed.2d 170 (1983). Trading was effected surreptitiously and substantial profits were made. The Circuit reversed the District Court's dismissal of the indictment, which charged the defendants with securities fraud, mail fraud and conspiracy. The court did not require that a fraud be

perpetrated against either the buyer or seller of a security. Rather, the court found a fraud perpetrated against the employer sufficient:

> The wrongdoing charged against appellee and his cohorts was not simply internal corporate mismanagement. In *United States v. Chiarella*, Chief Justice Burger, in dissenting, said that the defendant "misappropriated–stole to put it bluntly–valuable nonpublic information entrusted to him in the utmost confidence." That characterization aptly describes the conduct of the connivers in the instant case.
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> Had appellant used similar deceptive practices to mulct Morgan Stanley and Kuhn Loeb of cash or securities, it could hardly be argued that those companies had not been defrauded. By sullying the reputations of Courtois' and Antoniu's employers as safe repositories of client confidences, appellee and his cohorts defrauded those employers as surely as if they took their money.

Id. at 17 (citations omitted). The opinion also states that Newman and his colleagues wronged the clients of the investment banking firms, "whose takeover plans were keyed to target company prices fixed by market forces, not artificially inflated through purchases by purloiners of confidential information." *Id.*

More recently, the Second Circuit reaffirmed its acceptance of the misappropriation theory in a case which was *Chiarella's* facts revisited. *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, ___U.S.___, 105 S.Ct. 2112, 85 S.Ct. 477 (1985). Materia was a copyholder in a financial printing firm, who also learned how to fill in the blanks in tender offer documents handled by his employer. He too purchased the target companies' securities and made substantial profits when the offers were made public. The Court firmly restated the essential holding of *Newman*: "one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) and Rule 10b–5." *Id.* at 203.

Winans is said to have misappropriated a certain type of market-sensitive confidential information—the nature and timing of Wall Street Journal articles. The theft of this information is said to have operated as a fraud on the Wall Street Journal, which was in connection with the purchase and sale of securities in the featured stocks.

Relying on a number of arguments, defendants distinguish *Newman* and *Materia* on the grounds that Winans' conduct is entirely different and is not a proper basis for a securities fraud violation. First, they argue that the premise of both *Materia* and *Newman* was that the employees in those cases had not only stolen information from their employers' clients—the acquiring companies. Without such a third party, to find Winans' conduct to be a misappropriation of information would lead to what they perceive as a major inconsistency—the Wall Street Journal could trade on such information because it could not misappropriate information from itself.[6] In contrast, the employers in both *Newman* and *Materia* would not have been able to trade on the information, since they would still be misappropriating information from their clients.[7]

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6. We do not see why it is such an anomaly that an employer and an employee could not be prosecuted under the same theory. We agree with the government that this argument is reminiscent of Chiarella's unsuccessful Second Circuit claim that because a tender offeror could purchase up to 5% of the target stock without disclosure, he too should be allowed to trade prior to a public announcement. *United States v. Chiarella*, 588 F.2d at 1366. It was in the course of explaining why Chiarella should not be treated like the offeror that the court discussed the alternative misappropriation theory.

7. The first indictment filed in this case alleged that Winans "violated his duties owed to the readers of the Wall Street Journal, including a duty to disclose that Winans and his co-conspirators had traded in securities knowing that the Wall Street Journal would publish articles written by Winans or others concerning those securities; that Winans and his co-conspirators traded in such securities expecting that such columns or articles would affect the price and with the intent to profit from the change in price and that Winans and his co-conspirators intended to and did trade in such securities by selling their stock or options or covering short sales immediately after such columns or articles appeared, with the intent to profit from the change in price." The defendants argue that when the government dropped the theory resting on a duty to the WSJ readers, it lost its ability to follow the analysis of *Materia and Newman*. We disagree for the reasons stated in the text.

First, we note that the language of both *Materia* and *Newman* strongly supports a reading that the existence of third parties is not an essential element. The *Newman* decision discussed the wrong to the employer as a separate matter with the wrong to the clients mentioned as an additional point: the focus of the holding was on the fiduciary relationship between employer/employee. *See Newman, supra*, 664 F.2d at 17–18. While the *Newman* facts involved an additional harm to a third party, the case nowhere states that the harm to the employer must also encompass some harm to a client. Similarly, in *Materia*, the court emphasized the fraud on the employer and not whatever wrong was committed against the client:

> Among a financial printer's most valuable assets is its reputation as a safe repository for client secrets. By purloining and trading on confidences entrusted to Bowne, it cannot be gainsaid that Materia undermined his employer's integrity. . . Accordingly, we are driven to the conclusion that, by his misappropriation of material nonpublic information, Materia perpetrated a fraud upon Bowne.

745 F.2d at 202 (citation omitted). Once again, the facts included some harm to a third party, but the language of the case in no way implies that the misappropriation theory requires anyone outside the employer/employee relationship to have been affected. While the defendants phrase the distinction in terms of the existence of a contractual relationship, trying to confine *Materia* and *Newman* to the facts in this way is an implicit return to the view that a securities fraud can only be perpetrated against a buyer or seller of securities, a view clearly rejected in *Newman*. 664 F.2d at 17.

To support the argument that a client is a necessary figure in the misappropriation theory, defendants rely heavily on *Dirks v. SEC*, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983). Dirks was an investment analyst who received material, non-public information from insiders of Equity Funding, which indicated that the assets of the corporation were "vastly overstated as the result of fraudulent corporate practices." *Id.* at 649, 103 S.Ct. at 3258. Although he himself did not trade on

the information, he disclosed it to a number of clients and investors who sold their holdings in Equity Funding. The *Dirks* opinion attempted to delineate who fell within the purview of "insider trading" and reiterated the holding of *Chiarella* that a duty to disclose can only exist if there is a "specific relationship between the shareholders and the individual trading on inside information." *Id.* at 655, 103 S.Ct. at 3261. To find a derivative breach, there must have been a breach by a corporate insider of a duty owed to the company's shareholders about which the tippee knew or should have known. *Id.* at 660, 103 S.Ct. at 3264. In its famous footnote fourteen, the *Dirks* Court explained that a certain category of temporary insiders, or quasi–insiders, such as lawyers and accountants, would also have such a duty: "For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed non–public information confidential, and the relationship must imply such a duty." *Id.* at 655 n. 14, 103 S.Ct. at 3261 n. 14.

To find *Dirks* controlling would be to find no securities violation here, since Winans was not a temporary insider, did not owe any duty to the corporations he wrote about, and was not a tippee of any corporate inside information. In terms of the securities laws, neither Winans nor the Wall Street Journal owed any duties at all to the corporations that were the subject of *Heard* columns or to the shareholders of those corporations. However, the duties that *Dirks* addressed are not the ones under scrutiny in *Newman, Materia* or here. *Dirks* simply did not address the misappropriation theory, the Court having found that Dirks did not "misappropriate or illegally obtain the information." *Id.* at 665, 103 S.Ct. at 3267; *see also Bateman Eichler, Hill Richards, Inc. v. Berner*, ___U.S.___, ___, 105 S.Ct. 2622, 2630, 86 L.Ed.2d 215 (1985).

The *Dirks* case outlined the contours of one type of insider trading, where a corporate insider or his tippee perpetrates a fraud on the shareholders in breach of a corporate duty. That Newman or Materia might have been prosecuted as footnote fourteen insiders does not undermine the Second Circuit's misappropriation analysis, which focuses on the employer/employee fraud, an entirely different relationship from the one at issue in *Dirks*. *Materia* was decided after *Dirks*, and the absence of any discussion of the case leads us to conclude that the Circuit did

not believe that the tipper/tippee approach was relevant to the misappropriation theory.[8]

The essential point is that the misuse of corporate inside information is not the only type of fraud that the securities laws cover, which was made clear in *Materia*:

> We hold that such activity falls squarely within the "fraud or deceit" language of the Rule. Legislative history to the Securities Exchange Act of 1934 makes clear that the antifraud provision was intended to be broad in scope, encompassing all "manipulative and deceptive practices which have been demonstrated to fulfill no useful function." S. Rep. No. 792, 73d Cong., 2d Sess., 6 (1934). This language negates the suggestion that the provision was aimed solely at the eradication of fraudulent trading by corporate insiders.

745 F.2d at 201. It is not accurate to say that *Dirks* wrote the book on insider or outsider trading; it wrote one chapter with respect to one type of fraudulent trading. That type is not before us. [9]

Nor do we believe that the misappropriation theory hearkens back to the "parity of information" doctrine, which has been rejected by the Supreme Court. That doctrine states in essence that all investors should have relatively equal access to

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8. On March 13, 1985, the SEC filed a Notice of Motion for Leave to Participate as Amicus Curiae, with an accompanying Memorandum of Law in Opposition to the Defendants' Motions for Acquittal. We hereby grant the motion. One of the points that the SEC makes is that the Commission addressed *Dirks* in its brief to the Second Circuit in *Materia*. The government also states that Materia made *Dirks*–based arguments in his brief to the Second Circuit.

9. The misappropriation theory has been found to support an indictment involving the tipping of corporate inside information. In *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y. 1985), there was no allegation that the corporate insider tipped his son for personal gain. Since such a finding is essential to *Dirks*' derivative liability, that case's analysis was inapplicable. Nonetheless, Judge Ward upheld the indictment on the misappropriation theory.

material information in order to preserve the market's integrity. Brudney, "Insiders, Outsiders, and Informational Advantages under the Securities Laws," 93 Harv. L. Rev. 322, 339 (1979). *Chiarella's* holding that "a duty to disclose under Section 10(b) does not arise from the mere possession of non-public market information" clearly rejects any approach based on a mere informational advantage. 445 U.S. at 235, 100 S. Ct. at 1118; see also *Dirks*, *supra*, 646 U.S. at 657, 103 S.Ct. at 3262. The *Chiarella* majority also did not accept the view that an informational advantage which is not "legally available to others," known as the access to information theory, should be the basis for drawing the line. 445 U.S. at 235 n.20, 100 S. Ct. at 1118 n.20; *see also Dirks*, *supra*, 463 U.S. at 672, 103 S. Ct. at 3270. But we do not agree that the misappropriation theory is in conflict. The focus of the approach before us is not whether the defendant had an informational advantage that *others* could not legally obtain, but on how the defendant gained the advantage, which must be fraudulently.

To look at conduct rather than information is actually quite consistent with *Dirks*, in which the Supreme Court also held that a corporate insider only breaches a duty to shareholders if he or she personally benefits from the disclosure. In support of that point (which was sharply disputed by the dissenters), a statement by SEC Commissioner Smith was approvingly quoted: "It is important in this type of case to focus on policing insiders and what they do . . . rather than policing information per se and its possession." *Dirks*, *supra*, 463 U.S. at 662–63, 103 S. Ct. at 3265.

What made the conduct here a fraud was that Winans knew he was not supposed to leak the timing or contents of his articles or trade on that knowledge. He knew that these columns were likely to affect the price of the stocks to his benefit. This is true even if he had not known of a written policy; he had knowledge of a Wall Street Journal practice, that is, a rule of conduct, which makes this a clear breach of a fiduciary duty. The government concedes that without any policy, there could be no prosecution under the misappropriation theory. We are not entirely sure that such a concession was necessary, but we understand it to mean that, if the Wall Street Journal could not show that it had set out the rules, it could not be said that

Winans had breached any duty. The contention that criminal liability cannot be premised on as broadly-stated and aspirational a set of guidelines as the Dow Jones policy is just not persuasive. While the policy itself tries to cover many ethical grey areas, and it may be difficult to tell whether some conduct fits within the guidelines, this case does not present any such problems. Winans breached the policy and he knew he was breaching it.

Nor do we find the fact that criminal liability is being premised on corporate internal policy unprecedented. The indictment in *Newman* charged the defendants with "violating the fiduciary duties of honesty, loyalty and silence owed directly to [the investment banking firms], and clients of those investment banks," duties as broadly phrased as any found in the conflicts policy. 664 F.2d at 16. Similarly, Materia's fraud was the violation of a company policy, and the fraud was defined as a breach of a fiduciary duty. *Materia*, *supra*, 745 F.2d at 203. In the mail fraud context, the question of criminal liability premised on internal corporate policy has been addressed directly, and endorsed, rather than found troublesome:

> Our discussion is not to be construed as holding that an employee's duty to disclose material information to his employer must be imposed by state or federal statute. Indeed, the employment relationship, by itself, may oblige an employee not to conceal, and in fact to reveal, information he has reason to believe is material to the conduct of his employer's business.

United States v. Von Barta, 635 F.2d 999, 1007 (2d Cir. 1980), *cert. denied*, 450 U.S. 998, 101 S. Ct. 1703, 68 L.Ed.2d 199 (1981). Even if we could accept newspaper articles as definitive proof that other newspapers do not have similar policies, that would not change the result in this case, where we are dealing with a specific employment relationship.[10]

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10. On January 21, 1985, the Reporters' Committee for Freedom of the Press, the National Association of Broadcasters, the Newsletters Association, the New York Financial Writers Association, the Media Institute, the Newspaper Guild, the Radio-Television News Directors Association, the

Counts Twenty–Six through Forty–Three charge the defendants with wire fraud in violation of 18 U.S.C. § 1343. The same trades form the basis for Counts Forty–Four through Sixty–One in violation of 18 U.S.C. § 1341, the mail fraud statute.[11] The parallel language of both statutes has led courts to give them both the same construction. *Von Barta*, *supra*, 635 F.2d at 1005 n.11. For ease of discussion, we will only refer to the mail fraud charges.

These "seemingly limitless provisions," *id.* at 1001, prohibit the use of the mails to execute "any scheme or artifice to defraud or for obtaining money or property by means of false or fraudulent pretense, representations or promises," 18 U.S.C. § 1341.[12] While the language of the statutes may be broad, the

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American Society of Magazine Editors, the National Newspaper Association, and the Associated Press Managing Editors filed a motion for leave to file a brief as amici curiae in support of defendants' Rule 29 motion to dismiss various counts of the indictment. They filed another motion for leave to file a supplemental memorandum on April 23, 1985. Because of the timing of the latter motion, we did not require the government to respond to the points raised. However, we hereby grant both motions.

The arguments made by the amici with respect to the proper construction of the securities laws are adequately addressed in the text. Amici make a more narrow argument that states in essence that the government's theory rests on ill–defined duties for reporters and editors; criminalization of breaches of those duties will interfere with the editorial process and will create a threat to the amici's First Amendment freedoms. We are not persuaded that the government's theory does create any new duties; as the government stated in their reply brief, "this prosecution under the 'misappropriation' theory creates no obligations, but merely enforces pre–existing obligations as it finds them." Nor does the theory impose any duties at all on publishers and editors as to what they must do if a reporter does disclose trading or tipping. Editors must make decisions about whether or not to run articles all the time, and this theory does not affect that choice at all. If Winans were to have disclosed to his editors prior to publication the fact that he was trading in the stock slated to be the subject of a *Heard* column the following day, the editors had several choices open to them, including running the column and taking disciplinary action against Winans for his misconduct, as well as seeking criminal penalties.

11. The government dropped Count 40 as to Carpenter and Felis, Count 43 as to Felis, and Counts 58 and 61 as to Carpenter and Felis.

12. Defendants acknowledge that "[i]ntangibles such as 'confidential and nonpublic commercial information' fall within the definition of 'property'

government's theory of the case follows two specific routes of analysis. First, the government argues that Winans' conduct constituted an abuse of his employers' confidences, and under one line of cases meets the requirements of a fraudulent scheme for that reason alone. *Haas v. Henkel*, 216 U.S. 462, 30 S. Ct. 249, 54 L.Ed. 569 (1910); *United States v. Hasenstab*, 575 F.2d 1035 (2d Cir.), *cert. denied*, 439 U.S. 827, 99 S.Ct. 100, 58 L.Ed.2d 120 (1978); *United States v. Girard*, 601 F.2d 69 (2d Cir.), *cert. denied*, 444 U.S. 871, 100 S.Ct. 148, 62 L.Ed.2d 96 (1979); *Abbott v. United States*, 239 F.2d 310 (5th Cir. 1956); *United States v. Kent*, 608 F.2d 542 (5th Cir.1979), *cert. denied*, 446 U.S. 936, 100 S.Ct. 2153, 64 L.Ed.2d 788 (1980); *United States v. Buckner*, 108 F.2d 921, 924–25 (2d Cir.), *cert. denied*, 309 U.S. 669, 60 S.Ct. 613, 84 L.Ed. 1016 (1940); *United States v. Groves*, 122 F.2d 87, 90 (2d Cir.), *cert. denied*, 314 U.S. 670, 62 S.Ct. 135, 86 L.Ed.536 (1941). Alternatively or additionally, the government argues that the fraud was Winans' breach of a fiduciary duty owed to the Wall Street Journal, when he had a duty to disclose both the leaks and his own trading to his employer. *Von Barta*, *supra*, 635 F.2d 999; *United States v. Bronston*, 658 F.2d 920 (2d Cir. 1981), *cert. denied*, 456 U.S. 915, 102 S.Ct. 1769, 72 L.Ed.2d 174 (1982); *United States v. Margiotta*, 688 F.2d 108 (2d Cir. 1982), *cert. denied*, 461 U.S. 913, 103 S.Ct. 1891, 77 L.Ed.2d 282 (1983); *United States v. Siegel*, 717 F.2d 9 (2d Cir. 1983); *United States v. Weiss*, 752 F.2d 777 (2d Cir. 1985).

On the facts of this case, these theories overlap and become virtually indistinguishable. Winans' disclosures can only be seen as an abuse of his employers' confidences since he owed a fiduciary duty to the Wall Street Journal not to disclose the contents of the column in advance. Analogous facts tested the theory in *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), a case already discussed in connection with the

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under the mail fraud statue." *United States v. Newman*, 664 F.2d 12, 19 (2d Cir. 1981) (quoting *United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896, 99 S. Ct. 257, 58 L.Ed.2d 243 (1978)). Nonetheless, they object to that construction in light of the absence of any express ruling by the Supreme Court on the issue.

securities counts. In reversing the district court's dismissal of the indictment, the Second Circuit found the indictment's charges of fraudulent misappropriation of confidential information and the failure to disclose material information where there was a fiduciary duty to do so "a sufficient averment of wrongdoing" under the mail fraud statute and the applicable case law. *Id.* at 19–20.

Defendants argue that the mere breach of a fiduciary duty or an employee's failure to honestly serve his employer cannot serve as the basis for a mail fraud prosecution. *Weiss*, *supra*, 752 F.2d 777; *Siegel*, *supra*, 717 F.2d at 14. However,

> [t]he additional element which frequently transforms a mere fiduciary breach into a criminal offense is a violation of the employee's duty to disclose material information to his employer.

Von Barta, *supra*, 635 F.2d at 1006; *see also Weiss*, *supra*, 752 F.2d 777; *Siegel*, *supra*, 717 F.2d 9. This is not a case in which the government can be accused of bootstrapping a duty to disclose onto a fiduciary duty. Even Winans' admission that he knew that what he was doing violated a "practice," which if discovered would result in his dismissal, leads inexorably to a finding that he breached a fiduciary duty. His conduct also establishes his awareness that he had a duty not to disclose the content and timing of publication of the column as well as a duty to disclose, at the very least, any leaks of the column.

The argument that Winans' theft of confidential information was not necessarily a fraud fails because of the existence of a duty to disclose.[13] It is entirely irrelevant that he did not have

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13. It is a bit absurd to say that an element of Winans' crime was that he did not tell the Wall Street Journal he was committing it. But, what distinguishes our case from a "mere breach of a fiduciary duty" is the same element that existed in *Newman*: "[t]he scheme included breach of the employees' fiduciary duties by material misrepresentations to the employer and non-disclosure of material information required to be disclosed." *Newman*, *supra*, 664 F.2d at 19. Winans may not have made any material misrepresentations to his employer before the SEC investigation, but he knew all along that the Journal cared about leaks. The scheme was also a fraud and not a "mere theft" because the scheme's "'object was to filch from [the employer]

to break into any locked files to find out when his own articles were going to run. Whatever ambiguities may lurk in the language of the Dow Jones Conflicts of Interest Policy, the activity Winans participated in did not fall between any of the cracks. Even if Winans' testimony is accepted in its entirety, he did not have to be aware of the existence of a Conflicts of Interest Policy, much less a written one, to know that his activities violated a practice, were unethical and would lead to dismissal. The level of notice required to let an employee know that his conduct would amount to a breach of a fiduciary duty has been accepted on much weaker facts than these. *Von Barta, supra*, 635 F.2d at 1002 (high–level employee with a great deal of discretion verbally admonished "never to jeopardize the firm's banking relationships" and always to advise his employer if the firm's repurchase agreements "were in trouble").

Other elements of the mail fraud counts are also contested. The government must prove "that some actual harm or injury [to the scheme's victims] was at least contemplated." *Von Barta, supra*, 635 F.2d at 1006 n.14. It need not be proven or alleged that the victim was actually defrauded, since the statutes forbid a scheme to defraud and not actual fraud. *United States v. London*, 753 F.2d 202, 205 (2d Cir. 1985). Like the securities counts, the mail fraud charges rest on the theory that the Wall Street Journal was the victim of the fraud. The harm suffered was an alleged reputational injury; as a result of having a reporter engaged in such unethical conduct, the Wall Street Journal's reputation for journalistic integrity was sullied. Defendants argue that there was no harm to the alleged victim as a matter of fact, and that reputational injury is too nebulous and ill–defined to support a mail fraud violation.

As to the question of whether the Wall Street Journal's reputation suffered as a result of this matter, the point is not revelant. Defendants questioned a number of witnesses about their perceptions of the Journal's reputation and introduced evidence relating to the financial success of the newspaper in the past year. Government witnesses also testified to their views of

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its valuable property by dishonest, devious, reprehensible means.'" *Id.* at 19 (quoting *Abbot v. United States*, 239 F.2d 310, 314 (5th Cir. 1956)).

the newspaper's reputation; they recited anecdotes about strained relationships with sources and complaints from readers about reporters "on the take." Obviously, whatever reputational damage occurred in connection with the events of this trial, the Wall Street Journal has not been driven out of business.

All that must be shown is that "some harm or injury was contemplated by the alleged scheme." *London, supra*, 753 F.2d at 206; *see also Siegel, supra*, 717 F.2d 9. Further, "[harm or injury] may be inferred 'when the scheme has such effect as a necessary result of carrying it out.'" *London, supra*, 753 F.2d at 206 (quoting *United States v. Regent Office Supply Co.*, 421 F.2d 1174, 1181 (2d Cir. 1970)). The scheme's injurious consequences to the Journal must have been known to Winans. It is obviously untenable to argue, as the defendants do, that since the conspirators never intended to get caught, they could not have contemplated that the Wall Street Journal would be harmed.

In the most relevant case law, the misappropriation of confidential information has virtually been presumed to be injurious to the employer whose confidence is betrayed. *See Materia, supra*, 745 F.2d 197; *Newman, supra*, 664 F.2d 12. Defendants distinguish those cases on the ground that the injury to reputation in those circumstances was premised on the contractual relationship between the employer and the employer's client; that is, the corporate clients who entrusted their takeover and merger plans to investment banking firms and printers are necessary third parties to make the reputational injury fly. We fail to see the significance of that distinction for the reasons already discussed in the securities law section.

Moreover, the fraudulent misappropriation or theft of the WSJ's property is in itself sufficient to satisfy the requirement of contemplation of harm. The theft of valuable property is of course a crime even if the victim is unaware of the loss. Here, the fraudulent taking and misuse of the confidential information stolen from the WSJ placed immediately in jeopardy probably its most valuable asset—its reputation for fairness and integrity. These conspirators, with their intimate knowledge of the financial and stock markets and of the influential role that the *Heard* column played in these markets, were hardly

unaware of the potentially devastating harm that their fraudulent acts could cause to the WSJ.

All of the defendants assert that the mailing and wiring of Winans' articles is an insufficient jurisdictional basis for the mail and wire fraud counts. The mailing requirement is another limitation placed on the breadth of the statutes:

> The federal mail fraud statute does not purport to reach all frauds, but only those limited instances in which the use of the mails is a part of the execution of the fraud, leaving all other cases to be dealt with by appropriate state law.

Kann v. United States, 323 U.S. 88, 95, 65 S.Ct. 148, 151, 89 L.Ed. 88 (1944). The use of the mails must be "incident to an essential part of the scheme." *Pereira v. United States*, 347 U.S. 1, 8, 74 S.Ct. 358, 363, 98 L.Ed. 435 (1954). Moreover, one "causes" the mails to be used "[w]here one does an act with knowledge that the use of the mails will follow in the ordinary course of business or where such use can reasonably be foreseen, even though not actually intended." *Id.* at 8–9, 74 S.Ct. at 362–363.

The defendants argue that the telexing of articles for printing and the mailing of the Wall Street Journal to subscribers were legitimate, routine and inevitable uses of the wires and mails, wholly unaffected by Winans' trading activity. Whether or not Winans wrote a Heard on the Street column, and whether or not he provided leaks to Brant about the column, the Wall Street Journal would have been published every day. Moreover, they argue that Winans was required to write his articles for publication as a condition of his employment; he fulfilled that obligation by writing his "journalistically pure" columns.

Defendants primarily rely on a Third Circuit case, which held that the mailing of packing slips with phonographic records was an insufficient basis for a mail fraud charge. *Tarnopol v. United States*, 561 F.2d 466, 472 (3d Cir.1977). While there is language in the opinion dealing with the routine nature of the business mailings at issue, the case did not create any per se rule for routine business mailings. Rather, as the Third Circuit subsequently explained:

> [*Tarnopol*] merely applied the already established notion that mailings which are too remote from a fraudulent scheme will not support a mail fraud charge.

United States v. Brown, 583 F.2d 659, 667 (3rd Cir.1978), *cert. denied*, 440 U.S. 909, 99 S.Ct. 1217, 59 L.Ed.2d 456 (1979). The packing slips of *Tarnopol* were not only legitimate and routine mailings, but were also entirely unrelated to the scheme. In fact, the court noted that "the fraud would have been better served if no packing slips had been in existence." *Tarnopol, supra*, 561 F.2d at 473.[14]

Here, however, the publication and distribution of the Wall Street Journal was an integral part of the scheme to defraud. While defendants argue that the mailings were *unaffected* by the fraud, they do not, and cannot assert that the mailings were *unrelated* to the scheme, which is the proper focus. The fact that an innocent third party actually made the jurisdictional communication is of no consequence, since the wirings and mailings were reasonably foreseeable. *United States v. Muni*, 668 F.2d 87, 89 (2d Cir.1981). This is hardly a situation where the nexus between the mailings and wirings and the alleged fraud is too remote; without publication and distribution of the copies of the Journal containing the columns in question there would be no point to the scheme.[15]

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14. Nor is this case anything like *Parr v. United States*, 363 U.S. 370, 80 S.Ct. 1171, 4 L.Ed.2d 1277 (1960) where the mailing of a tax bill was held to be insufficient to substantiate a mail fraud charge, even though the defendants subsequently embezzled the proceeds. The legal mandate compelling the mailings in *Parr* is not analogous to Winans' employment requirements. In *Parr*, the Court noted that "the factual situation is unique," *id.* at 391, 80 S.Ct. at 1183, that is, the mailing in question was required by law. Moreover, the Court relied substantially on the fact that the indictment did not allege that the mailings were part of the offense. *Id.* at 392, 80 S.Ct. at 1184.

15. Testimony from Daniel Hinson, an Assistant Managing Editor of the WSJ, Richard L. Graff, an Associate National Circulation Service Manager at Dow Jones & Co. and Kenneth Rodin, a general supervisor at the U.S. Postal Service established that these stories were transmitted by telecopier from the Wall Street Journal at 22 Cortlandt Street, New York, New York to Chicopee, Massachusetts and elsewhere for printing in the newspaper.

The government must also establish that the defendants acted with specific intent, a discussion equally applicable to the mail, wire and securities fraud counts. *Dirks, supra*, 463 U.S. at 663 n. 23, 103 S.Ct. at 3265 n. 23. As the Second Circuit stated:

> This specific intent requirement is sometimes used to distinguish actual and constructive fraud. Actual frauds are intentional frauds. Constructive frauds involve breaches of fiduciary or equitable duties where intent to deceive is lacking. Only actual frauds are within the purview of the mail fraud statute.

Von Barta, supra, 635 F.2d at 1005 n. 14 (citations omitted). The basic definition of this term is

> To act with "intent to defraud" means to act knowingly and with the specific intent to deceive ordinarily for the purpose of either causing some financial loss to another, or bringing about some financial gain to one's self.

2 Devitt & Blackmar, Federal Jury Practice and Instructions §47.08 (3d ed. 1977); Sand, Modern Federal Jury Instructions ¶44.01 (1984); *United States v. Niro*, 338 F.2d 439, 440 n.2 (2nd Cir.1964).

The essence of the defendants' argument is that to have intended to defraud the Wall Street Journal, each defendant would have to know the specifics of the conflicts of interest policy. Their argument goes so far as to say that each defendant had to know the precise language of the written conflicts policy that was being violated.

We do not agree that the specific intent requirement is meant to be quite that specific. Nor do we believe that such a precise knowledge of what type of wrong Winans was committing at the Journal is necessary to show that any defendant aided and abetted the fraud. The government is not required to

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The newspapers are also mailed to some 22,000 subscribers in the Southern District of New York.

prove actual knowledge by each defendant, of every detail that made the scheme a fraudulent one. Nor is the government required to show that the defendants intended to violate the law, since ignorance of the law is no defense. *See, e.g., United States v. Gregg*, 612 F.2d 43, 50 (2d Cir.1979); *United States v. Berardelli*, 565 F.2d 24, 30 (2d Cir.1977).

Our focus is on whether the defendants intended to deceive the Journal, or aided and abetted Winans in his efforts to deceive the Journal. The defendants need not have known about every particular of the conflicts of interest policy to have knowledge that the Wall Street Journal was being defrauded by Winans for his own financial gain.

With respect to the mail and wire fraud counts (as well as the securities fraud counts), good faith would be a complete defense: the burden is on the government to show lack of good faith beyond a reasonable doubt. *United States v. Bronston*, 658 F.2d 920, 930 (2d Cir.1981), *cert. denied*, 456 U.S. 915, 102 S.Ct. 1769, 72 L.Ed.2d 174 (1982). This defense is raised by Felis, who asserts that he never believed that this arrangement was illegal. He relies, in part, on a conversation with Brant, although Felis knew that Clark was the source of that legal opinion. He also relies on the conversation with Krantz.

Reliance on the advice of counsel is not an absolute defense, but is one factor to be considered in assessing good faith and intent. *United States v. Financial Committee to Re-Elect the President*, 507 F.2d 1194 (D.C.Cir.1974). Essential to any claim based on reliance on counsel is that the attorney must have been fully informed of all the relevant facts. *United States v. Stirling*, 571 F.2d 708, 735 (2d Cir.), *cert. denied*, 439 U.S. 824, 99 S.Ct. 93, 58 L.Ed.2d 116 (1978); *United States v. King*, 560 F.2d 122, 132 (2d Cir.), *cert. denied*, 434 U.S. 925, 98 S.Ct. 404, 54 L.Ed.2d 283 (1977). It is also a difficult argument to make when the attorney whose advice was relied on was a participant in the scheme: in such a case, "legal assurance was not sought because acting within the framework of the law was not the reason appellants elected to deal with members of the Bar." *United States v. Shewfelt*, 455 F.2d 836, 839 (9th Cir.), *cert. denied*, 406 U.S. 944, 92 S.Ct. 2042, 32 L.Ed.2d 331 (1972). Any attorney whose advice is later used to

establish good faith must have been "unbiased and competent." *Financial Committee, supra*, 507 F.2d at 1198.

Defendants also argue that this criminal prosecution offends the Due Process clause, since they lacked fair notice of the criminality of their conduct. As the Second Circuit has stated,

> All the Due Process clause requires is that the law give sufficient warning that men may conduct themselves so as to avoid that which is forbidden, and thus not lull the potential defendant into a false sense of security, giving him no reason even to suspect that his conduct might be within its scope.

United States v. Herrera, 584 F.2d 1137, 1149 (2d Cir.1978). There need not be any litigated fact pattern directly on point. *United States v. Ingredient Technology Corp.*, 698 F.2d 88, 96 (2d Cir.), **cert. denied**, 462 U.S. 1131, 103 S.Ct. 3111, 77 L.Ed.2d 1366 (1983). The fair notice argument has been repeatedly rejected in the Rule 10b–5 context on a wide variety of fact patterns. *Newman, supra*, 664 F.2d at 18–19; *Chiarella*, 588 F.2d at 1369; *United States v. Brown*, 555 F.2d 336, 339–40 (2d Cir.1977); *United States v. Persky*, 520 F.2d 283, 286–88 (2d Cir.1975); *SEC v. Shapiro*, 494 F.2d 1301, 1308 (2d Cir.1974). Defendants' numerous deceptive acts hardly support the notion that they had no idea that they were committing a wrongful act. As the Circuit remarked in *Newman*, "[i]n other areas of the law, deceitful misappropriation of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, has consistently been held to be unlawful," and defendants "would have had to be most ingenuous to believe that Congress intended to establish a less rigorous code of conduct under the Securities Acts." *Newman, supra*, 664 F.2d at 18.

III

We conclude as follows. The conspiracy began on October 16, 1983, when Winans and Brant agreed to trade on advance information concerning the timing and content of Wall Street Journal articles. Felis was promptly informed by Brant of the arrangement and agreed to participate. The three of them continued as active participants in the conspiracy to defraud and to obstruct justice when the SEC began its investigation in March 1984. The evidence which we have reviewed in detail above establishes beyond any doubt the fraudulent scheme, to which each of them knowingly and wilfully subscribed. With the exception of the first three trades (relating to American Surgery and Institutional Investors) listed in the indictment as overt acts, each of the remaining overt acts were committed by a conspirator in the Southern District of New York at the time alleged in furtherance of the conspiracy.

We find that Carpenter never joined the conspiracy with Winans, Brant and Felis. He initially had a vague understanding of a business arrangement between the three; the nature of that arrangement became clearer to him over time, and by the end of the year he was fully aware of what was going on. We are loathe to dwell on Carpenter's "spousal relationship" defense, since it carries with it assumptions about spousal roles which would only be true for the most subservient spouse. Nevertheless, the government has not shown beyond a reasonable doubt that Carpenter ever reached any agreement with the other conspirators. The arrangement was never substantively discussed in his presence, his participation was never sought until the last month, and, with the exception of Brant's gift of travel money, Carpenter was never given a share of the profits distinct from Winans' share. He was treated as Winans' uninvolved spouse, consistent with the nature of their relationship; he did not act as a conspirator, nor was he perceived as such by Winans, Brant or Felis.

Nor was the role played by Carpenter in the last month of the scheme, when the SEC began its investigation, that of a conspirator. He primarily acted as a messenger boy between Winans and Brant and Felis. There is no question that he produced the fake invoices. However, Carpenter stalled

repeatedly before finally producing the invoices under substantial pressure from Brant and Felis. They were also done so badly that Carpenter's handiwork may well have been a deliberate failure to comply with any plan to obstruct justice. Indeed, those invoices were never used to thwart the SEC investigation, but were revealed to the SEC by Carpenter himself at the time of his voluntary testimony. In short, he was at no time a willing participant in any aspect of the conspiracy.

We do not find Felis' assertions of good faith believable. He argues that he never believed the trading arrangement to be illegal or improper except from a Kidder Peabody "appearance" point of view. This is said to explain Felis' lies to Kidder Peabody executives and his trip to Switzerland to open the Western Hemisphere account. However, while Brant did tell Felis that the arrangement was legal at the time of its inception, Felis was aware that the source of this legal advice was David Clark. Not only was Clark a participant in the scheme, but Felis' own witness, Casey Enright, testified that she and Diane Hackett told him not to trust Clark.

Nor can Felis rely on the meeting with Krantz, in which Krantz expressed some confusion about the Supreme Court's recent pronouncements on insider trading. Krantz did not have all the material facts, since Brant and Felis had lied to him, and he never stated that trading on advance information from the WSJ was not illegal. The testimony of Brant's and Felis' assistants that Brant, Felis and Krantz emerged from that meeting all smiles, is fully consistent with what happened at that meeting. Krantz thought the problem was solved by Clark's decision to move his trading and Brant and Felis thought the problem was solved because Kidder Peabody was satisfied that they were doing nothing illegal. Felis' conduct throughout demonstrates that he was a willful and knowing participant in what he understood was an unlawful venture.

As to the securities counts, Winans and Felis employed devices, schemes and artifices to defraud and engaged in acts, practices and a course of business which operated as a fraud and deceit on the Wall Street Journal and Dow Jones & Co., Inc. Each did so by means and instrumentalities of interstate commerce, the mails and facilities of national securities

exchanges in connection with the purchase of sale of securities alleged in the securities counts.[16] We find that Winans and Felis, together with Brant, each had the requisite specific intent to defraud.

Carpenter, although not a conspirator, did aid and abet the scheme. During his one and a half years at the WSJ, he became aware of the rules of the game and consequently knew that what Winans was doing was fraud on the WSJ. He endorsed the checks made out to him by Brant or Felis, allowed Winans to trade in his name in the Merrill Lynch and Schwab accounts, and to that extent willfully participated in the criminal venture and helped it succeed.

We make no distinctions between the various counts, finding none of the defendants' distinctions persuasive. It makes no difference that one transaction was charged as mail and wire fraud, but not as securities fraud, or that the government combined trades in two different accounts in some counts, but charged those transactions separately in others. Nor does it make a difference that some of these transactions resulted in losses. *Materia* does require that the trading be to the defendant's "own advantage," but that language speaks to the intent requirement insofar as the misappropriator must have been motivated by personal gain; we do not agree that the misappropriator must have made a profit on each transaction. Moreover, all of these trades were pursuant to a long-term plan. The three losing trades show that the venture was not entirely risk-free, but there is no doubt that the arrangement was very profitable as a whole. Lastly, there is no principled distinction between columns written by someone other than Winans or articles other than *Heard* columns; the crime was in the disclosure of the newspaper's contents and the trading on the basis thereof.

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16. Winans and Felis, as parties to the conspiracy, are each responsible for the substantive offenses committed by a co-conspirator in furtherance of the conspiracy, regardless of any participation in the substantive offense or any actual knowledge of that offense. *Pinkerton v. United States*, 328 U.S. 640, 645-48, 66 S.Ct. 1180, 1183-85, 90 L.Ed. 1489 (1946).

As to mail and wire fraud counts, Winans and Felis devised and participated in a scheme and artifice to defraud the Wall Street Journal and to obtain money and property of the WSJ by means of false and fraudulent pretenses and representations. Once again, Carpenter aided and abetted the scheme to the extent charged in the indictment. Each defendant, by virtue of the scheme itself, contemplated harm to the Journal's reputation. Winans caused the jurisdictional mailings and wirings by submitting them for publication after leaking them to Brant and Felis.

Accordingly, we find defendant Winans guilty on Counts 1 through 18, 20 through 24, and 26 through 61, inclusive, as charged in the superseding indictment. We find David Carpenter guilty on Counts 14, 17, 18, 21, 22, 24, 38, 41, 42, 56, 59 and 60. Lastly, we find defendant Felis guilty of Counts 1 through 13, 15, 16, 20, 23, 26 through 33, 36, 37, 39, 41, 44 through 51, 54, 55, 57 and 59. Dates for sentencing will be determined in consultation with counsel.

SO ORDERED.

Supreme Court, U.S.
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No. 86-422

In the Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, AND R. FOSTER WINANS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Whether petitioners' trading in securities on confidential information that had been misappropriated in breach of a fiduciary duty violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

2. Whether petitioners' trading in securities on the basis of this misappropriated information violated the mail and wire fraud statutes, 18 U.S.C. 1341 and 1343.

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In the Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-422

DAVID CARPENTER, KENNETH P. FELIS, AND R. FOSTER WINANS, PETITIONERS

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-29a) is reported at 791 F.2d 1024. The opinion of the district court (Pet. App. 33a-73a) is reported at 612 F. Supp. 827.

JURISDICTION

The judgment of the court of appeals was entered on May 27, 1986. Petitions for rehearing were denied on July 17, 1986 (Pet. App. 30a-31a). The petition for a writ of certiorari was filed on September 15, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

After a bench trial in the United States District Court for the Southern District of New York, petitioners Felis and Winans were convicted of conspiracy to commit fraud and to obstruct justice, in violation of 18 U.S.C. 371; they and petitioner Carpenter also were convicted of a number

of counts charging securities fraud, in violation of 15 U.S.C. 78j(b), 17 C.F.R. 240.10b-5, and 18 U.S.C. 2; mail fraud, in violation of 18 U.S.C. 1341; and wire fraud, in violation of 18 U.S.C. 1343. Petitioner Carpenter was sentenced to concurrent terms of three years' probation and to concurrent $1000 fines on six counts of securities fraud, three counts of mail fraud and three counts of wire fraud. Petitioner Winans was sentenced to concurrent terms of 18 months' imprisonment on one count of conspiracy, five counts of mail fraud, and five counts of wire fraud; he also was assessed concurrent $5000 fines on the conspiracy count and on each of five counts of securities fraud, as well as concurrent $1000 fines on five counts of mail fraud and five counts of wire fraud, and was placed on five years' probation. Petitioner Felis was sentenced to concurrent six month sentences on one conspiracy count and on five counts each of securities, mail, and wire fraud; he also was fined a total of $25,000 (specifically, fines of $10,000 on the conspiracy count, $5000 on one count of securities fraud, and $1000 on each of five counts of mail and of wire fraud), and was placed on five years' probation.

1. Petitioner Winans was a reporter for the Wall Street Journal (Journal) and one of two full-time writers responsible for the Journal's "Heard on the Street" column (Heard column) (Pet. App. 5a, 35a). This widely-read column is a daily feature that typically discusses significant developments concerning a particular stock or group of stocks and expresses a point of view about the prospects for the company or stock reviewed (*ibid.*). The column often has a significant impact on the market price of the stocks that it discusses (*id.* at 17a n.8, 19a n.9, 35a-36a).

When Winans was hired, and periodically thereafter, he was informed that Dow Jones & Co., the Journal's publisher, maintained a conflicts of interest policy prohibiting its employees from purchasing or selling securities in anticipation of forthcoming articles (Pet. App. 6a, 36a-37a).

The policy further provided that "all material gleaned * * * in the course of * * * work for Dow Jones is deemed to be strictly the company's property" and "must never be disclosed to anyone outside the Company." Specifically placed in this category was "information on plans for running items and articles on particular companies." *Id.* at 36a; C.A. App. 113.[1]

2. Despite his awareness of the Dow Jones policy, in October 1983 Winans entered into an agreement with two stockbrokers at Kidder, Peabody & Co. (Kidder), Peter Brant and petitioner Felis, to leak confidential information concerning "the timing, subject, and tenor" of future Heard columns (Pet. App. 40a).[2] The agreement envisioned

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[1] Petitioners state that this policy was "contained at the back of a 40-page pamphlet" (Pet. 6), was not contained in Dow Jones' collective bargaining agreement with Winans' union (*id.* at 7), and was "convoluted, ambiguous, and technical" (*id.* at 18 n.38). The district court, however, found that "Winans had actual knowledge of the policy with respect to maintaining the confidentiality of the column," and that he "also knew that he was supposed to tell his editors if he heard that word was out about a column's topic"; the court found "incredible Winans['] denial that he ever received the conflicts of interest policy statements" (Pet. App. 37a; see *id.* at 6a).

[2] Petitioners state that "[a]t Winans' insistence * * * it was agreed that neither the accuracy nor the journalistic integrity of any article would be compromised, and this promise was fulfilled" (Pet.7). The district court, however, noted (Pet. App. 45a) Winans' testimony before the Securities and Exchange Commission that the "promise of a big distribution of profits" from Brant "was 'an inducement' and a factor in his choosing" to write about a certain stock. While the court noted Winans' later testimony that he in fact exercised independent journalistic judgment in deciding to write the column in question, the district judge did "not accept [Winans'] rejection of his SEC testimony; rather, [he] accepted it as evidence of Winans' criminal intent." *Ibid.* In any event, the court found that "[m]aintaining the journalistic purity of the column was actually consistent with the goals of the conspirators" because "a particularly compelling column or a fresh investment thesis would have a significant impact on the price of the featured stock" (*id.* at 44a n.4).

that Brant and Felis would use Winans' information to trade on the stocks to be discussed in the column, with the conspirators sharing the profits (*id.* at 6a-7a, 40a-42a). Petitioner Carpenter, a former news clerk at the Journal and a close friend of Winans, acted as a messenger between the conspirators (*id.* at 5a-6a).

Over a five-month period, Winans leaked advance information to Brant and Felis concerning approximately 27 columns (Pet. App. 7a). Using this information, Brant and Felis engaged in large-scale securities transactions, buying stock or call options in advance of positive columns, and selling short (or buying put options) in advance of negative columns (*id.* at 6a, 42a). By generally closing their position on the day of publication, they took maximum advantage of the Heard column's short-term market impact (*id.* at 42a). Winans also used his knowledge about forthcoming columns to trade for the account of Carpenter, who assisted in the completion of six such transactions (*id.* at 45a). These activities netted petitioners and their confederates trading profits of almost $700,000 (*id.* at 7a, 42a).

During the course of the scheme, petitioners adopted elaborate strategems to avoid detection. Winans telephoned Brant or Felis from empty Journal offices or outside pay phones and frequently used a false name when identifying himself to Brant's secretary (Pet. App. 7a, 42a). Felis and Brant in turn paid Winans his share of the trading profits by checks made payable to Carpenter. To support a cover story that those checks represented payments for decorating services, Felis wrote the word "drapes" on a $10,000 check; Carpenter subsequently provided Brant and Felis with false invoices for decorating services (*id.* at 7a, 40a, 43a, 47a-49a).

Petitioners and Brant continued trading in securities even after their activities had aroused suspicion. When questioned by Kidder's Regional Manager, Felis and Brant

lied about the source of their information; after being told to stop their trading, they liquidated their existing account but opened a Swiss bank account in the name of a shell corporation through which they continued to trade (Pet. App. 7a, 46a). Petitioners and Brant subsequently misled the Securities and Exchange Commission (SEC) and the Journal when questioned about their activities (*id.* at 7a, 47a-48a).

3. Petitioners were convicted following a 20-day bench trial. In sustaining the convictions for securities fraud, the district court explained that " 'one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) [of the Securities Act of 1934, 15 U.S.C. 78j(b)] and Rule 10(b)(5) [17 C.F.R. 240.10b-5]' " (Pet. App. 53a (citation omitted)). In this case, the court explained, "[w]hat made the conduct * * * a fraud was that Winans knew he was not supposed to leak the timing or contents of his articles or trade on that knowledge. * * * Winans breached the [Dow Jones] policy and he knew he was breaching it" (*id.* at 58a-59a).

The court also held that the government had established its allegations of mail and wire fraud, explaining that Winans' breach of duty and failure to disclose material information to the Journal served as an appropriate basis for the prosecution; the court noted Winans' "awareness that he had a duty not to disclose the content and timing of publication of the column as well as a duty to disclose, at the very least, any leaks of the column" (Pet. App. 62a). The court also found that the scheme involved "the fraudulent misappropriation or theft of the Journal's property" and that "[t]he scheme's injurious consequences to the Journal must have been known to Winans" (*id.* at 64a). Finally, the court held that the telexing of articles for printing and the mailing of the Journal to subscribers were "integral part[s] of the scheme to defraud" (*id.* at 66a).

4. The court of appeals affirmed petitioners' convictions (Pet. App. 1a-29a).[3] Addressing the securities law counts, the court found that Winans "breached a duty of confidentiality to his employer by misappropriating from the *Journal* confidential prepublication information" (*Id.* at 10a). This misconduct, the court explained, implicated Section 10(b) and Rule 10b-5, which "broadly proscribe[] the conversion by 'insiders' *or others* of material nonpublic information in connection with the purchase or sale of securities" (Pet. App. 11a (emphasis in original)). And "the use of the misappropriated information for the financial benefit of [petitioners] and to the financial detriment of those investors with whom [petitioners] traded," the court held, "supports the conclusion that [petitioners'] fraud was 'in connection with' the purchase or sale of securities under section 10(b) and Rule 10b-5" (*id.* at 18a).

The court found it unnecessary to "dwell at length on [petitioners'] convictions for violating federal mail and wire fraud statutes" (Pet. App. 23a). The court explained that confidential commercial information "may constitute fraudulently misappropriated 'property' under the mail fraud statute" (*ibid.*), and that petitioners' scheme to misappropriate nonpublic information from the Journal accordingly fell within the scope of 18 U.S.C. 1341 and 1343 (Pet. App. 24a). The court also concluded that the "foreseeability and centrality to the scheme" of the mailings and wirings associated with the publication and distribution of the Journal "were sufficient predicates to allow a conclusion that [petitioners] violated the mail and wire fraud statutes" (*id.* at 25a).[4]

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[3] The court of appeals reversed Winans' conviction on several counts involving trading by Felis that was outside the scope of the conspiracy (Pet. App. 26a-27a).

[4] Judge Miner joined the court's opinion insofar as it upheld petitioners' convictions on the mail and wire fraud counts, but he dissented from the court's holding on securities fraud (Pet. App.

ARGUMENT

Petitioners contend that their trading on misappropriated information violated neither the securities laws nor the federal mail and wire fraud statutes. These contentions are without merit. Both aspects of the court of appeals' holding were correct. The court's decision upholding petitioners' securities fraud convictions, moreover, involved a legal issue that has not been addressed outside the Second Circuit; its decision on the mail and wire fraud counts involved the application of settled principles. These holdings thus do not conflict with any rulings of this Court or of the other courts of appeals. Consideration of the case by this Court is unwarranted.

1. a. The securities fraud aspect of this case involves legal issues that have not been widely considered by the courts. The Second Circuit is the only court of appeals that has yet had occasion to address the "misappropriation of confidential information theory" upon which petitioners' convictions under Section 10(b) and Rule 10b-5 were based.[5] And as petitioners themselves recognize (Pet. 9), the factual background in this case—where the confidential information was misappropriated from a nonparticipant in the market—"make[s] it one of first impression even for the Second Circuit."[6] In the absence of

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27a-29a). He reasoned that "[n]o confidential securities information imparted by reason of any special relationship was purloined by [petitioners]," concluding that petitioners' "conduct is addressed adequately by statutes establishing the mail and wire fraud offenses of which [petitioners] stand convicted" (*id.* at 28a-29a).

[5] See *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985); *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), aff'd after remand, 722 F.2d 729 (2d Cir.), cert. denied, 464 U.S. 863 (1983). Cf. *Rothberg* v. *Rosenbloom*, 771 F.2d 818, 825 (3d Cir. 1985) (Higginbotham, J., concurring).

[6] In the other cases applying the theory, the misappropriated information derived from a market participant—a party planning a tender offer. See *SEC* v. *Materia, Supra; United States* v. *Newman, Supra*;

discussion of the issue by other courts (let alone a split in the circuits), consideration by this Court of the issues presented here would be premature.

b. In any event, petitioners' challenge to their securities fraud convictions is without merit. Section 10(b) prohibits the use, "in connection with the purchase or sale of any security," of "any manipulative or deceptive device or contrivance" in violation of rules promulgated by the SEC. Rule 10b-5 (emphasis added) in turn prohibits "*any* person" from engaging in "*any* act [or] practice" that "operates or would operate as a fraud or deceit upon *any* person" in connection with the purchase or sale of securities. This Court has consistently construed these provisions broadly, noting that Section 10(b) is "a 'catchall' clause to enable the Commission to 'deal with new manipulative or cunning devices' " (*Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976) (brackets omitted)) and that the statute and rule "are obviously meant to be inclusive." *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972). See generally *Herman & Maclean* v. *Huddleston*, 459 U.S. 375, 386 (1983); *United States* v. *Naftalin*, 441 U.S. 768, 773 (1979). See also S. Rep. 792, 73d Cong., 2d Sess. 6 (1934).

Against this background, the court of appeals properly held (Pet. App. 17a-18a) that petitioners' conduct amounted to a "fraud or deceit" within the meaning of Section 10(b) and Rule 10b-5. While petitioners find it anomalous that the fraudulent conduct here involved the breach of a duty to an employer (Pet. 11), Winans in fact

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SEC v. *Gaspar*, [1984-85] Fed. Sec. L. Rep. (CCH) ¶ 92,004 (S.D.N.Y. Apr. 15, 1985); *SEC* v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984).

misappropriated—"stole, to put it bluntly" (*Chiarella* v. *United States*, 445 U.S. 222, 245 (1980) (Burger, C.J., dissenting))—nonpublic information in breach of a duty of confidentiality.[7] "In other areas of the law, deceitful misappropriation of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, has consistently been held to be unlawful." *United States* v. *Newman*, 664 F.2d 12, 18 (2d Cir. 1981), aff'd after remand, 722 F.2d 729 (2d Cir.), cert. denied, 464 U.S. 863 (1983). This Court has noted that "misappropriation is a 'garden variety' type of fraud." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 11 n.7 (1971).[8]

Likewise, petitioners' fraud plainly occurred "in connection with" their purchases and sales of securities. Obviously, the "sole purpose" of petitioners' misappropriation scheme was to trade securities using the stolen information and thereby to " 'reap instant no-risk profits in the stock market' " (Pet. App. 19a-20a, quoting *SEC* v. *Materia*, 745 F.2d 197, 203 (2d Cir. 1984), cert. denied, No. 84-1036 (Apr. 22, 1985)). "[T]he misappropriated information had 'no value whatsoever' * * * except 'in connection with'

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[7] The Journal's policy, moreover, expresses recognized principles of law. As the court of appeals noted (Pet. App. 21a n.11), in some jurisdictions theft or embezzlement of certain confidential information is a statutory crime. The court also observed that, under the common law, " 'unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as agent, in competition with or to the injury of the principal, on his own account or on behalf of another * * * unless the information is a matter of general knowledge.' " *Id.* at 10a n.5 (quoting Restatement (Second) of Agency § 395 (1958)).

[8] Outside the securities context, the Court also has found similar breaches of fiduciary duty to be fraudulent. See, *e.g.*, *United States* v. *Carter*, 217 U.S. 286, 305-310 (1910); *Wardell* v. *Railroad Co.*, 103 U.S. 651, 654-659 (1880).

[petitioners'] subsequent purchase[s and sales] of securities' " (*id.* at 19a, quoting *SEC* v. *Materia*, 745 F.2d at 203). Indeed, this Court has twice suggested that trading on "misappropriate[d] or illegally obtain[ed] information"—the activity in which petitioners engaged—constitutes fraud in violation of Rule 10b-5. *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 313 n.22 (1985); *Dirks* v. *SEC*, 463 U.S. 646, 665 (1983).[9] See also H.R. Rep. 98-355, 98th Cong., 1st Sess. 4-5, 14-15 (1983).[10]

Petitioners nevertheless assert (Pet. 9-13) that their scheme did not violate Rule 10b-5 because the Journal, the party whose information they deceitfully misappropriated and traded upon, was not itself a participant in the market. But both the language and the purpose of Rule 10b-5 fit this case. The rule proscribes any scheme that operates as a fraud "upon any person" "in connection with the purchase or sale of any security." See *Naftalin*, 441 U.S. at 773 (stating, with respect to language nearly iden-

[9] Indeed, four Justices have read Section 10(b) and Rule 10b-5 "to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading." *Chiarella*, 445 U.S. at 240 (Burger, C.J., dissenting). See *id.* at 239 (Brennan, J., concurring in the judgment); *id.* at 245 (Blackmun, J., joined by Marshall, J., dissenting). The other members of the Court found it inappropriate to address the validity of the misappropriation theory in *Chiarella*. See *id.* at 235-237; *id.* at 238 (Stevens, J., concurring).

[10] There is no merit to petitioners' suggestion (Pet. 12) that the decision of the court of appeals is inconsistent with *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977). *Santa Fe Industries* held that breach of a fiduciary duty by corporate management, which is primarily a concern of state law, does not violate Rule 10b-5 when unaccompanied by "any deception, misrepresentation, or nondisclosure." 430 U.S. at 476. But petitioners engaged in just that sort of fraudulent misconduct. Nothing in *Santa Fe Industries* stands for the proposition that fraudulent conduct in connection with trading in securities may not be prosecuted under Rule 10b-5 when it also involves a breach of duty that is actionable under state law.

tical to that of Rule 10b-5(a), that "nothing in [Section 17(a)(1) of the Securities Act] creates a requirement that injury occur to a purchaser").[11]

Moreover, the obvious purpose of petitioners' fraud against the Journal was to obtain an advantage—one that was made possible by Winans' misappropriation of confidential information—over other buyers and sellers of securities. Thus the court of appeals specifically found (Pet. App. 18a) that petitioners used the information they misappropriated "for [their own] financial benefit * * * and to the financial detriment of those investors with whom [they] traded," adding that "those who purchased or sold securities without the misappropriated information would not have purchased or sold, at least at the transaction prices, had they had the benefit of that information."

c. Despite petitioners' contention to the contrary (Pet. 11, 13), there is nothing anomalous in the use of the misappropriation theory against an employee when it could not have been applied against the employer (in this case, the Journal) had the employer sought to trade on the misappropriated information. As the court of appeals explained (Pet. App. 21a), petitioners' argument "illogically casts the thief and [his] victim in the same shoes." The fraud that triggered application of Section 10(b) and Rule 10b-5 here was petitioners' *misappropriation* of confidential information and attendant breach of fiduciary duty to the Journal. See Pet. App. 15a-16a, 57a-58a.[12] Because

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[11] The plaintiff in a private action for damages under Section 10(b) and Rule 10b-5 must be a purchaser or seller of securities. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). This Court has made clear, however, that the purchaser-seller requirement is inapplicable in a government law enforcement action. *Id.* at 751 n.14, citing *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 467 n.9 (1969). See also *Naftalin*, 441 U.S. at 774 n.6.

[12] Hence, there also is no basis for petitioners' suggestion (Pet. 13 & n.19) that the decision below adopts a "parity of information" rule.

the Journal obviously cannot misappropriate anything from itself, any liability for its use of the information necessarily would have to rest on a different legal theory. In any event, petitioners' contentions about the Journal's potential liability for trading on *its own* information involve hypothetical issues that simply have no bearing on this case. The Journal effectively announced (through the very policy that Winans violated) that it would not engage in such conduct, it in fact did not do so—and the court of appeals left open the possibility that the Journal would be liable if it did engage in trading of that sort.[13]

Petitioners also argue (Pet. 13-15) that the nonpublic information involved in this case—Winans' advance knowledge of the timing and tenor of Heard columns—is not sufficiently securities-related to be the predicate for a violation of Section 10(b) and Rule 10b-5 because it did not bear on the "value or investment worthiness" of the stocks mentioned in the Heard columns. This contention

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Explicitly rejecting this contention, the court of appeals stated (Pet. App. 15a-16a):

> We do not say that merely using information not available or accessible to others gives rise to a violation of Rule 10b-5. * * * There are disparities in knowledge and the availability thereof at many levels of market functioning that law does not presume to address. * * * Obviously, one may gain a competitive advantage in the marketplace through conduct constituting skill, foresight, industry and the like. * * * But one may not gain such advantage by conduct constituting secreting, stealing, purloining or otherwise misappropriating material nonpublic information in breach of an employer-imposed fiduciary duty of confidentiality.

[13] The court of appeals recognized that this case does not present the question whether a legal theory other than the one used against petitioners would have precluded the Journal from trading on this information (Pet. App. 20a n.10). Cf. *Zweig* v. *Hearst Corp.*, 594 F.2d 1261 (9th Cir. 1979) ("scalping" theory of liability under Rule 10b-5); *SEC* v. *Blavin*, 557 F. Supp. 1304 (E.D. Mich. 1983), aff'd, 760 F.2d 706 (6th Cir. 1985) (scalping) (cited with approval in *Lowe* v. *SEC*, 472 U.S. 181, 209-210 n.56 (1985)).

plainly is without merit. Cf. *Dirks*, 463 U.S. at 657 n. 15. As the court of appeals noted, the information stolen by Winans unquestionably was material (Pet. App. 19a n.9). See *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). The Heard column had an immediate effect on the market price of the securities discussed in it. And petitioners themselves obviously believed that their advance knowledge of the Journal's publication plans was significant, for their entire scheme was premised on their ability to trade securities prior to publication of articles and thus to profit from the market's response.

In short, petitioners simply miss the point in asserting (Pet. 12) that their convictions should be overturned because Section 10(b) and Rule 10b-5 "protect investors, not reputations." In making this argument, petitioners fail to acknowledge the obvious: that their trading directly undermined the integrity of the securities markets. Their scheme permitted them to make trades that otherwise would not have occurred, and to do so with an advantage grounded on their use of fraudulently misappropriated information that was not lawfully available to the other parties to the transactions. Such conduct is the antithesis of the "open and honest market" for securities that Section 10(b) was intended to protect. *Materia*, 745 F.2d at 203. See *Naftalin*, 441 U.S. at 775 (emphasis omitted) (the securities laws aim " 'to achieve a high standard of business ethics * * * in every facet of the securities industry' ") (quoting *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-187 (1963)); see also *United States* v. *Brown*, 555 F.2d 336, 339 (2d Cir. 1977).

2. Petitioners also take issue with their mail and wire fraud convictions. It is revealing, however, that their challenge to the court of appeals' holding is grounded principally on *dissenting* opinions issued by judges in the Second and other circuits. See Pet. 15 nn. 21, 22; 17 nn. 30, 31, 33; 20 n.48; 22-23; 23 nn. 55-56. In fact, as peti-

tioners' own citations to *majority* decisions demonstrate (see Pet. 17 nn. 34, 35, 36), the court of appeals' unanimous holding affirming the mail and wire fraud convictions in this case involved the unexceptional application of settled law.

a. Petitioners first assert (Pet. 18-20) that their trading on misappropriated information did not amount to a "scheme or artifice to defraud" within the meaning of 18 U.S.C. 1341 and 1343 because it was grounded "*solely*" (Pet. 18 (emphasis in original)) on Winans' breach of fiduciary duty to the Journal. This contention is without merit. The courts uniformly have held that "the type of fraud which is perpetrated through a breach of the fiduciary duty owed by an employee to his employer [is] actionable under the mail and wire fraud statutes" (*United States* v. *Conner*, 752 F.2d 566, 572 (11th Cir. 1985), cert. denied *sub nom. Taylor* v. *U.S.*, No. 84-1853 (Oct. 7, 1985)), at least where the employee fails to disclose relevant information to the employer.[14] This reading of the statute is hardly of recent vintage, as petitioners suggest (Pet. 17). See, *e.g.*, *United States* v. *Groves*, 122 F.2d 87, 90 (2d Cir.), cert. denied, 314 U.S. 670 (1941). See generally

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[14] See, *e.g.*, *United States* v. *Weiss*, 752 F.2d 777, 784 (2d Cir. 1985), cert. denied, No. 84-1645 (Nov. 4, 1985); *United States* v. *Lemire*, 720 F.2d 1327, 1335-1336 (D.C. Cir 1983), cert. denied, 467 U.S. 1226 (1984); *United States* v. *Feldman*, 711 F.2d 758, 763 (7th Cir.), cert. denied, 464 U.S. 939 (1983); *United States* v. *Bronston*, 658 F.2d 920, 926 (2d Cir. 1981), cert. denied, 456 U.S. 915 (1982); *United States* v. *Shamy*, 656 F.2d 951, 957 (4th Cir. 1981), cert. denied, 455 U.S. 939 (1982); *United States* v. *Von Barta*, 635 F.2d 999, 1006 (2d Cir. 1980), cert. denied, 450 U.S. 998 (1981); *United States* v. *Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), cert. denied, 447 U.S. 928 (1980); *United States* v. *Castor*, 558 F.2d 379, 383 (7th Cir. 1977) (dictum), cert. denied, 434 U.S. 1010 (1978); *United States* v. *Keane*, 522 F.2d 534, 544-546 (7th Cir. 1975), cert. denied, 424 U.S. 976 (1976); *United States* v. *Bryza*, 522 F.2d 414, 421-422 (7th Cir. 1975), cert. denied 426 U.S. 912 (1976). Cf. *Gregory* v. *United States*, 253 F.2d 104, 109 (5th Cir. 1958).

Epstein v. *United States*, 174 F.2d 754, 766-767 (6th Cir. 1949). And the courts below found just such conduct in this case, where Winans' actions "establishe[d] his awareness that he had a duty not to disclose the content and timing of publication of the [Heard] column as well as a duty to disclose, at the very least, any leaks of the column" (Pet. App. 62a; see *id.* at 24a).[15]

This is not a case, moreover, in which the fraud involved "technical" breaches of duty or "trivial" misconduct (see Pet. 18). Petitioners' actions amounted, as we explain above, to a criminal violation of the securities laws. Even apart from that, those actions—which were part of a scheme "to filch from [the Journal] its valuable property by dishonest, devious, and reprehensible means" (Pet. App. 62a-63a n.13)—were similar to conduct that is criminal in a number of jurisdictions, that would be treated as an actionable breach of common law duties almost everywhere, and that long have been condemned as fraudulent (see page 9 & notes 7, 8, *supra*).[16] Petitioners' further observations that the Journal's rule of confidentiality was imposed unilaterally (Pet. 18), that an employee might learn of the rule only after commencing employment (Pet. 19), and that the court of appeals' ruling might be applicable in other factual settings (Pet. 20), are

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[15] The other petitioners, who schemed to take advantage of Winans' breach of duty, are equally liable for that breach. See *United States* v. *Alexander*, 741 F.2d 962, 964 (7th Cir. 1984).

[16] Petitioners assert (Pet. 18-19 & n.41) that the Journal's rules regarding confidentiality are not common practice in the industry. As the government explained to the court of appeals, however (C.A. Br. 63 n.**), the single newspaper story upon which petitioners rely for this surprising proposition was not admitted into evidence for this purpose by the district judge; in any event, the government pointed to other accounts indicating that most newspapers and magazines do in fact have a policy similar to that of Dow Jones.

simply beside the point: in this case, the fraudulent conduct plainly was improper, and was understood to be so by Winans and his colleagues (see Pet. App. 62a-63a).

b. Petitioners also contend (Pet. 20-21) that the harm inflicted on the immediate victim of their fraud—the injury to the Journal and its reputation—was not of a sort that can support a conviction under the mail and wire fraud statutes. Again, this assertion cannot be reconciled with the uniform holdings of the courts of appeals. The courts have made it clear that a scheme contemplating injury even to an intangible interest of the victim, such as one defrauding an employer of the loyal services of its employee, falls within the ambit of Sections 1341 and 1343.[17] Here, the Journal's reputation for integrity, while intangible, is "probably its most important asset" (Pet. App. 64a); petitioners' scheme posed the risk of causing "potentially devastating harm" to that asset (*id.* at 65a). And beyond the injury to the Journal's reputation, as the district court explained, "the fraudulent misappropriation or theft of the [Journal's] property [that is, its confidential publication information] is in itself sufficient to satisfy the requirement of contemplation of harm. The theft of valuable property is of course a crime even if the victim is unaware of the loss." *Id.* at 64a.

c. Finally, petitioners assert (Pet. 21-23) that they failed to "cause" the interstate mailings and wirings in this case with the "purpose" of executing their scheme. But Sections 1341 and 1343 never have been understood to re-

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[17] See, *e.g.*, *United States* v. *Lemire*, 720 F.2d 1327, 1337 (D.C. Cir. 1983), cert. denied, 467 U.S. 1226 (1984); *United States* v. *Margiotta*, 668 F.2d 108, 121 (2d Cir. 1982), cert. denied, 461 U.S. 913 (1983); *United States* v. *Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), cert. denied, 447 U.S. 928 (1980); *United States* v. *Condolon*, 600 F.2d 7, 9 (11th Cir. 1979); *United States* v. *Louderman*, 576 F.2d 1381, 1387 (9th Cir.), cert. denied, 439 U. S. 896 (1978); *United States* v. *Castor*, 558 F.2d 379, 383 (7th Cir. 1977), cert. denied, 434 U.S. 1010 (1978); *United States* v. *States*, 488 F.2d 761, 763-765 (8th Cir. 1973), cert. denied, 417 U.S. 909 (1974).

quire that the defendant personally deposit an item in a mailbox or place a call on a telephone. Instead, it is well-settled that "[w]here one does an act with knowledge that use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen * * * then he 'causes' the mails to be used." *Pereira* v. *United States*, 347 U.S. 1, 8-9 (1954) (citation omitted; emphasis in original).

In this case, Winans produced his columns and delivered them to his editors not only with the knowledge, but with the expectation and intention that they be wired to the Journal's printing plant and mailed to the Journal's subscribers. And "[t]his is hardly a situation where the nexus between the mailings and wirings and the alleged fraud is too remote; without publication and distribution of the copies of the Journal containing the columns in question there would be no point to the scheme" (Pet. App. 66a (footnote omitted)).[18] Where the defendant

[18] For this reason, the cases relied upon by petitioners for the proposition that their actions failed to satisfy the mailing and wiring requirements of Sections 1341 and 1343 (*United States* v. *Maze*, 414 U.S. 395 (1974); *Parr* v. *United States*, 363 U.S. 370 (1960); *Kann* v. *United States*, 323 U.S. 88 (1944); *United States* v. *Castile*, 795 F.2d 1273 (6th Cir. 1986); *United States* v. *Tarnopol*, 561 F.2d 466 (3d Cir. 1977)) (see Pet. 21, 23 n.54) are simply inapposite. Those cases held that—regardless of whether the defendants in fact "caused" the mailing (see *Maze*, 414 U.S. at 399)—the requirements of the mail fraud statute were not satisfied when "there was not a sufficient connection between the mailing and the execution of the defendants' scheme." *Id.* at 401. See *Kann*, 323 U.S. at 94; *Parr*, 363 U.S. at 391; *Castile*, 795 F.2d at 1278-1281; *Tarnopol*, 561 F.2d at 471-472. Here, in contrast, the mailings and wirings were essential to the success of petitioners' fraud. Petitioners' further argument (grounded on the dissenting opinion in *United States* v. *Green*, 786 F. 2d 247, 256-258 (7th Cir. 1986)) that they did not cause the mailings and wirings for the "purpose" of executing their scheme because they simply took advantage of material that had been mailed and wired for a lawful purpose advances an unnaturally crabbed reading of the statutes: Winans introduced columns into the interstate mails and onto the interstate

delivers materials for transportation interstate through the wires and mails, with the intention of using those materials (once transported) in a scheme to defraud, the requirements of Sections 1341 and 1343 are satisfied. See *United States* v. *Muni*, 668 F.2d 87, 89 (2d Cir. 1981); *United States* v. *Castor*, 558 F.2d 379, 385 (7th Cir. 1977), cert. denied, 434 U.S. 1010 (1978); *Gregory* v. *United States*, 253 F.2d 104, 109 (5th Cir. 1958). Cf. *United States* v. *Green*, 786 F.2d 247, 250 (7th Cir. 1986).[19]

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wires with the intention of using those columns to perpetrate a fraud, and with the knowledge that the columns would not be published if he disclosed his breach of duty.

[19] The other decisions cited by petitioners (Pet. 23-24 n.56) as rejecting this settled reading of the mail and wire fraud statutes are entirely off the point. *United States* v. *Hewes*, 729 F.2d 1302, 1322 (11th Cir. 1984), cert. denied *sub nom. Caldwell* v. *U.S.*, 469 U.S. 1110 (1985), held only that the mailings must play an integral role in the defendant's scheme. *United States* v. *Rabbitt*, 583 F.2d 1014, 1025-1026 (8th Cir. 1978), cert. denied, 439 U.S. 1116 (1979), and *United States* v. *McNeive*, 536 F.2d 1245, 1250-1251 (8th Cir. 1976), found the mail fraud statute inapplicable in cases where the defendants' conduct did not harm the "victims." And in *United States* v. *Lemire*, 720 F.2d 1327 (D.C. Cir. 1983), cert. denied, 467 U.S. 1226 (1984); *United States* v. *Edwards*, 458 F.2d 875, 880 (5th Cir.), cert. denied, 409 U.S. 891 (1972); and *United States* v. *Kelem*, 416 F.2d 346, 347 (9th Cir. 1969), cert. denied, 397 U.S. 952 (1970), the courts *affirmed* convictions under the mail and wire fraud statutes.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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REPLY BRIEF FOR PETITIONERS

Petitioners David Carpenter, Kenneth P. Felis and R. Foster Winans respectfully submit this reply to the Government's brief in opposition to our petition for a writ of certiorari.

ARGUMENT

I.

Review By This Court of the Judicially Created "Misappropriation Theory" of Criminal Liability Under SEC Rule 10b-5 Is Timely and Warranted

This case presents the issue of whether SEC Rule 10b-5 imposes criminal sanctions on a newspaper columnist for "misappropriating" his newspaper's publication schedule as part of a scheme to trade certain securities, even though his newspaper — the only alleged victim of securities fraud — has no interest in the securities traded. Apart from the special concerns raised by criminalizing certain professional conduct of a newspaper columnist,[1] the case squarely presents the broader issue of whether an alleged "fraud" against a person or entity having no interest in securities can constitute a criminal violation of laws chiefly intended to protect such interests.

As its primary response to our petition, the Government argues that review by this Court is "premature" because only one circuit court of appeals has considered or adopted the "misappropriation theory" of criminal liability under Rule 10b-5. Gov't Br. at 7-8. This argument is unpersuasive. Six years ago, arguing for affirmance of the Second Circuit's decision in *United States v. Chiarella*, 588 F.2d 1358 (2d Cir. 1978), *rev'd*, 445 U.S. 222 (1980), the Government itself urged this Court to adopt the "misappropriation theory." *Chiarella v. United States*, 445 U.S. 222, 235 (1980). The Court declined because the

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1. *See* Brief of the Reporters' Committee for Freedom of the Press, *et al.*, as Amici Curiae in Support of Petitioners ("Br. Reporters' Comm.").

misappropriation theory was not properly presented by the *Chiarella* record, 445 U.S. at 236–37, and left "the resolution of th[e] issue for another day." *Id.* at 238 (Stevens, J., concurring). In the six years since *Chiarella*, the Second Circuit not only adopted the misappropriation theory,[2] but, in this case, expanded it beyond anything contemplated by *Chiarella* so as to cover alleged injury to a financial newspaper's reputation despite the total absence of fraud against any securities investor. We do not challenge this Court's frequent practice of allowing new questions of law to "percolate" in the courts below before review here; but we submit that six years has provided sufficient percolation for an important issue expressly reserved by the Court — important not only for the development of the law but also for the growing number of defendants who have gone to prison pursuant to this unreviewed judicial gloss of an agency–created rule.

It is hardly surprising that consideration of the misappropriation theory has been confined to the Second Circuit. The theory is not available in private civil actions.[3] In criminal actions, the Justice Department has a long–standing practice of bringing insider–trading securities cases in the Southern District of New York — the only district where the United States Attorney's Office has a specialized unit for securities fraud.[4] SEC civil enforcement actions under the misappropriation theory[5] have likewise been largely centered in the

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2. *See, e.g., United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983).

3. *Moss v. Morgan Stanley Inc.*, 719 F.2d 5, 16 (2d Cir. 1983), *cert. denied sub nom. Moss v. Newman*, 465 U.S. 1025 (1984).

4. Our informal survey indicates that, of the more than 50 criminal securities prosecutions thus far brought for trading on inside information, all but one was brought in the Southern District of New York, and that one was disposed of by a guilty plea.

5. *E.g., SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985).

Southern District of New York, not only because of its role as the hub of financial activity but also because, inasmuch as most principal national stock exchanges are located in the Southern District of New York, jurisdiction based on "use of any facility of any national securities exchange," 15 U.S.C. § 78j(b), most naturally lies in that district for virtually all 10b–5 actions involving publicly traded securities.

Now that the Second Circuit has accepted the misappropriation theory, the Government is clearly in a position to keep *all* actions (i.e., criminal prosecutions and civil enforcement actions) based on that theory within the confines of the Second Circuit, and indeed would have a strong incentive to do so if some one–circuit rule could immunize the theory from review by this Court. Fortunately, there is no such immunity. As *Chiarella* itself demonstrates, this Court has never hesitated to review (and reverse) the Second Circuit's decisions, regardless of the fact that, as is usually the case in this area, the issues have not been considered by any other circuit.

Review is timely for other reasons as well. The decision of the Second Circuit majority has far–reaching implications for individuals who are subjected to novel criminal prosecutions, as well as for the operation of this nation's securities markets and the workings of the press. *See* Brief Amicus Curiae in Support of the Petition for a Writ of Certiorari filed by the Securities Industry Association, Inc. and Br. Reporters' Comm. One needs only to open any newspaper to understand the importance of clear rules on criminal liability in insider–trading cases.[6] With additional

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6. Williams, "What's Legal — And What's Not," Fortune, Dec. 22, 1986, at 36–37 ("The SEC has a manhunt on for inside traders. But the rules are so vague that its hard for arbitragers — and managers — to know if and when they have sinned."); Editorial, "SEC v. ?", *Wall Street Journal*, Nov. 20, 1986, at 34, col. 1 ("The problem with the SEC is that the crime it presumably is pursuing, 'insider trading', has for some time now

prosecutions looming on the horizon, a ruling by this Court on the scope of these federal securities laws is necessary to alleviate the widespread confusion that now exists. No financial issue today is more topical or important.

In its second argument, the Government, having first argued that review is "premature" and that the issues here are of first impression, reverses its field and argues that review is inappropriate because this case involves shopworn principles of insider trading. Gov't Br. at 8–11. Relying upon piecemeal citations to the extremely broad language of section 10(b) and Rule 10b–5,[7] the Government wholly disregards the limitations placed by this Court on liability under these provisions. In *Chiarella*, and again in *Dirks v. SEC*,[7] this Court held there can be no violation of Rule 10b–5 unless there is some relationship between the shareholders of a company affected by securities transactions and the defendants accused of trading on material non–public information. When this Court in *Chiarella* contemplated (without deciding) the misappropriation theory, it did so within these parameters. *See* 445 U.S. at 233. As the dissent below made clear, this crucial limitation was not respected by the Second Circuit majority, and presumably will not be respected in future prosecutions under the theory of this case. More generally, the opinion below recognized that it represented an important decision of "first impression." *United States v. Carpenter*, 791 F.2d 1024, 1027 (2d Cir. 1986), Appendix to Petition for Writ of Certiorari at 8a.

Not only is the decision below unprecedented and unwarranted, it actually flies in the face of this Court's decisions in *Chiarella* and *Dirks* by silently accepting

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lacked clear definition. No wonder the markets are uncertain ... see[ing] cases trying to further stretch the definition of 'insider' trading, ... since such an expansion could reduce, rather than expand, the amount of information available to the market.").

7. 463 U.S. 646 (1983).

rationales expressly rejected in those cases. Thus, although the Government denies that this case is a return to the previously rejected parity-of-information rule, its position dictates just that result. The Government argues that petitioners "fraudulently misappropriated information that was not lawfully available to the other parties to the transactions" (Gov't Br. at 13), totally ignoring the fact that information upon which the trades were made was not taken in breach of any duty owed to these parties or indeed to any market participant. Petitioners owed absolutely no duty to these purchasers. The decision below is thus clearly contrary to the holdings of this Court on the necessity of a duty and injury cognizable under the securities laws to support liability under the securities laws.[8]

In short, review by this Court is not only timely and appropriate, it is utterly necessary if the force of this Court's prior decisions in this area is to be respected.

II.

The Lower Court's Unbridled Expansion of The Mail and Wire Fraud Statutes Warrants Review and Reversal

The Government's characterization of petitioners' mail and wire fraud convictions as an "unexceptional application of settled law" fails fairly to acknowledge the growing stream of criticism among courts and

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8. As for the Government's claim that there is nothing anomalous about an insider-trading rule that applies to an employee but not to the employer, the short answer is that Rule 10b-5 allows no such distinction. It applies only to breaches of fiduciary duties cognizable under the federal securities laws, and then to such breaches by employer and employee alike. Winans' breach of his duty to his employer, which was not a market participant and which itself created the duty breached through its unilateral proclamation of an internal policy designed to protect its reputation, is simply an insufficient predicate for petitioners' convictions.

scholars over the unbridled judicial expansion of these statutes. With every such expansion, more and more judges, dissenters though they be, have levelled ever more urgent warnings against such expansion. *See* Petition for Writ of Certiorari at 23–24 nn.55–57.

This case, representing the most extreme application of this expansion to date, is thus an appropriate vehicle for review of this expansion by this Court, which has never before reviewed it. The Government, like the Second Circuit, points to no "fraud" in this case, but only to Winans' failure to disclose to his newspaper that he had breached its private workrules by disclosing its publication schedule. This expansion of the concept of "fraud" to include all breaches of a privately-defined fiduciary duty by an employee requires reversal. The mail and wire fraud statutes should not be construed to federalize the ordinary relationship between employer and employee. The potential criminalization not only of all private workrules, but of every breach of a fiduciary obligation, constitutes an abusive distortion of the intended purposes of these federal statutes. *See United States v. Siegel*, 717 F.2d 9, 24 (2d Cir. 1983) (Winter, J., dissenting).

The Government also mischaracterizes petitioners' argument based upon the requirement of the statutes that the mailing or wiring be made "for the purpose of executing" a fraudulent scheme. Of course, petitioners never said the statutes require that "the defendant personally deposit an item in the mailbox or place a call on a telephone." Gov't Br. at 16–17. Instead, it is the decision below that has done violence to the terms of the statute by effectively eliminating the requirements of both causation and purpose. The cases cited by the Government are inapposite, involving situations in which the mailings and wirings were somehow part of a fraudulent scheme and would not have occurred in the same form or with the same content without the fraud. *Pereira v. United States*, 347 U.S. 1 (1954) (completion of a confidence fraud

requiring mailing of a check to drawee bank that would not have occurred but for the fraud); *United States v. Muni*, 668 F.2d 87, 90 (2d Cir. 1981) (completion of credit card fraud to give "appearance of legitimacy" by causing wirings by a merchandiser, as part of authorization process, that would not have occurred but for the fraud); *United States v. Castor*, 558 F.2d 379, 386 (7th Cir. 1977) (execution of liquor permit fraud furthered by mailings would not have occurred but for the fraud), *cert. denied*, 434 U.S. 1010 (1978).

In this case, the so-called "fraud" — Winans' unauthorized disclosure of his employer's publication schedule — was entirely completed before any of the predicate mailings or wirings took place. Moreover, neither the timing nor content of any of the mailings or wirings was affected by any aspect of the scheme — the articles appeared in the *Wall Street Journal* exactly as they would have without Winans' unauthorized use of his employer's publication schedule. By permitting convictions of mail and wire fraud to be based on such tenuous predicates, the lower court has removed all bounds to federal criminal jurisdiction under the statutes. This alone warrants review and reversal in this case.

CONCLUSION

For the reasons set forth above, petitioners respectfully request that this Court issue a writ of certiorari to review the judgments of the Court of Appeals for the Second Circuit.

Dated: December 9, 1986

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No. 86-422

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS,
and R. FOSTER WINANS,

Petitioners,

—v.—

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Securities Industry Association, Inc. ("SIA") respectfully moves this Court, as *amicus curiae*, for leave to file the accompanying brief in support of the petition for a writ of *certiorari*. The consent of counsel for each of the petitioners herein has been obtained, but counsel for respondent United States of America has not consented to the filing of a brief by SIA as *amicus curiae*.

As set forth in more detail in the accompanying brief, SIA is the principal trade association of the securities industry, and is generally recognized as the spokesman for the securities industry in general and the broker-dealer community in particu-

lar. As such, SIA has an interest in this case, in which the court below expanded the coverage of the federal securities laws to redress breaches of the internal policy concerning business ethics of a private, non-securities related corporation, when neither the duty nor the injury are within the intended protections of the federal securities regulatory scheme. This holding, which also conflicts with Supreme Court precedent on the scope of Section 10(b) and Rule 10b-5, has caused confusion in the securities industry.

Wherefore, SIA respectfully requests that this Court grant its motion for leave to file the accompanying brief as *amicus curiae*.

Dated: October 15, 1986

Respectfully submitted,

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IN THE

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF *CERTIORARI*

PRELIMINARY STATEMENT

Securities Industry Association, Inc. ("SIA") submits this brief as *amicus curiae* in support of petitioners, and urges this Court to issue a writ of *certiorari* to the United States Court of Appeals for the Second Circuit with respect to the opinion below in *United States* v. *Carpenter*, 791 F.2d 1024 (2d Cir. 1986) (per Pierce, J. and Mansfield, J.). Pursuant to Rule 36.1 of the rules of this Court, the written consent of petitioners David Carpenter, Kenneth P. Felis and R. Foster Winans has

been obtained. Consent of respondent United States of America has not been granted.

INTEREST OF SECURITIES INDUSTRY ASSOCIATION, INC.

SIA is the principal trade association of the securities industry, having as its members more than five hundred securities brokers and dealers transacting business both nationally and internationally. Its membership is responsible for over ninety percent of the securities brokerage business conducted in this country, and includes members of every national securities exchange, as well as securities firms that are not members of any exchange.

SIA's members service securities investors of every size and type and perform a complete spectrum of professional securities activities, including retail and institutional brokerage, over-the-counter market-making, underwriting and other investment banking activities, various exchange floor functions, and money management and investment advisory services. In the course of performing these functions, SIA's members execute thousands of securities transactions of all types each day and are constantly receiving and disseminating information in connection with these transactions. SIA and its members have been in the forefront of efforts to enforce the federal securities laws governing trading on inside information, and to prevent and detect the misuse of such information. Accordingly, SIA's members have a keen interest in understanding, with as much certainty as possible, the scope of the insider trading proscriptions in the federal securities laws that are the subject of the opinion below.

The uncertainty created by the opinion below presents substantial problems for SIA's members. SIA members are now unable to know with any certainty whether transactions that they effect may constitute a breach of some non-securities related duty owed by a client to a third party, which breach

may subject these members to criminal or civil liability under the federal securities laws. Thus, a third party, who is not even in the securities industry, may, because of its private decisions on internal corporate policy and business ethics, determine the scope of criminal liability under the securities laws. The problem is especially difficult for SIA's members to resolve when, as here, the information at issue does not fit within traditional concepts of material non-public information.

REASONS FOR GRANTING A WRIT OF *CERTIORARI*

SUMMARY OF ARGUMENT

The federal securities laws are intended to protect the investing public, not to enforce the ethical ideals of a newspaper. The Second Circuit, by predicating a securities fraud solely upon the breach of a journalist's duty to his newspaper, has expanded the reach of the federal securities laws beyond the intent of Congress and the requirements articulated by this Court, and has thus caused tremendous confusion in the securities industry. Unless this Court lays to rest the uncertainties engendered by the Second Circuit's opinion, there could well be substantial adverse effects upon this nation's capital markets. Brokers and dealers, and their employees, may be inhibited in their daily functions, thus hindering the free flow of information and the transaction of business that is crucial to the efficient working of this nation's securities markets. This is especially true because the government has apparently chosen to test novel and expansive theories of liability for securities fraud under statutes providing for criminal—rather than civil—penalties. SIA respectfully submits that the petition for a writ of *certiorari* should be granted in order to eliminate the substantial confusion, created by the opinion below, that now exists in the securities industry concerning the scope of the insider trading proscriptions in the federal securities laws.

ARGUMENT

I.

THE OPINION OF THE SECOND CIRCUIT MAJORITY CONFLICTS WITH SUPREME COURT PRECEDENT.

The opinion of the Second Circuit majority in this case conflicts with the holdings of this Court interpreting Section 10(b) and Rule 10b-5,[1] which limit the scope of these antifraud provisions to cases in which corporate insiders—or those with whom they are in privity—breach fiduciary duties by trading on material information not available to shareholders of the corporations with whom they trade.[2] In *Chiarella* v. *United States*, 445 U.S. 222, 230 (1980), this Court stated that Rule 10b-5 applies only where there exists "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction," and held that a financial printer who, because of his employment, obtained advance information of proposed

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1 Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), prohibits the use "in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of" any rule promulgated by the Securities and Exchange Commission ("SEC"). SEC Rule 10b-5, in turn, broadly proscribes any act that "would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

2 The SEC itself, notwithstanding its recent attempts to expand the reach of Rule 10b-5, recognized the intended reach of the federal securities laws in its initial applications of the antifraud provision. In *Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961), the SEC explained Rule 10b-5 as follows:

> An affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders. We, and the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment.

See also SEC v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (*en banc*), *cert. denied*, 394 U.S. 976 (1969).

takeover bids, owed no duty to the sellers of the securities that he purchased.

In *Dirks* v. *SEC*, 463 U.S. 646, 653 (1983), this Court reiterated the limitations on the scope of Rule 10b-5, holding that there must exist a specific relationship—direct or derivative—between the shareholders of the company affected by the securities transaction and the individual who trades on material non-public information.[3] Hence, this Court held that Dirks, a broker who obtained information from employees of Equity Funding that the company's assets were vastly overstated, was not liable under Rule 10b-5 for disclosing this information to certain of his clients prior to public dissemination of the news.[4]

And, in *Chiarella*, when this Court considered what is now known as the "misappropriation theory" of liability for securities fraud, it was done within these well articulated limits.[5] 445

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3 Although the Supreme Court recognized that *Dirks* involved an "unusual" set of facts, it nonetheless stated that "the principle at issue here extends beyond these facts." 463 U.S. at 658 n.18.

4 In its oft-quoted footnote 14, this Court made clear that corporate insiders may include not only corporate officers, directors and large shareholders, but temporary insiders such as lawyers, investment bankers, accountants, consultants and others who have entered into a special confidential relationship in the conduct of the corporation's business and are given access to material non-public information solely for corporate purposes. 463 U.S. at 655 n.14.

5 This Court has not yet ruled on the viability of the "misappropriation theory", which has been the subject of much criticism. The fundamental flaw in the "misappropriation theory" is that a breach of duty to an employer or an employer's clients is not a "securities fraud" within the ambit of Rule 10b-5, which this Court expressly recognized in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977):

> To the extent that the Court of Appeals would rely on the use of the term 'fraud' in Rule 10b-5 to bring within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction, its interpretation would, like the interpretation rejected by the Court in *Ernst & Ernst* [v. *Hochfelder*, 425 U.S. 185, 199 (1976)], 'add a gloss to the operative language of the statute quite different from its commonly accepted meaning.'

Misappropriation of information may be unethical, but it is not in all cases a fraudulent or deceptive act concerning the purchase or sale of securities.

U.S. at 235-36. The printing house in *Chiarella* was a *Dirks* "temporary insider" of the corporations who entrusted it with confidential information concerning proposed tender offers.[6] Yet that predicate is conspicuously absent here.

In this case no such relationship or duty existed between Winans and the sources of his information. None of the defendants here was a temporary insider, as this Court used that term in *Dirks*, and none possessed material non-public information relating to the issuers of the securities he traded. There is not even the suggestion that the corporate insiders who were Winans's sources of information acted at all improperly in divulging the information that was the subject of Winans's columns. The only non-public information at issue was *The Wall Street Journal's* publication schedules. The use or abuse of that information is not the sort of conduct Congress sought to address in enacting the federal securities laws. Indeed, unless a parity of information requirement, rejected by this Court in *Chiarella*, 445 U.S. at 231-33, is read into Section 10(b), there is no basis in the federal securities laws for the extension of those laws to the conduct at issue here.

The facts of this case fall well outside the boundaries set by Congress and this Court for liability under Section 10(b) and Rule 10b-5. The duty upon which criminal liability was based—Winans's non-securities related duty to his newspaper—is simply not a sufficient predicate for securities fraud under this Court's pronouncements in *Chiarella* and *Dirks*. Nor is it sufficient to support application of the "misappropriation theory" as contemplated by this Court in *Chiarella*.

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6 Indeed, the prior applications of the "misappropriation theory" by the Second Circuit were based on this rationale. *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985) (breach of duty by employee of financial printer to clients who entrusted the printer with material non-public information concerning tender offers); *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983) (breach of duty by employee of investment bank to clients).

II.

THE OPINION OF THE SECOND CIRCUIT MAJORITY CONFLICTS WITH THE INTENT AND PURPOSE OF SECTION 10(b) AND RULE 10b-5.

The purpose of Section 10(b) and Rule 10b-5 is to protect the investing public from fraudulent practices in connection with purchases and sales of securities. *E.g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194-95 (1976); *see* S. Rep. No. 47, 73d Cong., 1st Sess. (1933) (Securities Act of 1933). Yet, at every turn, the majority's decision in *Carpenter* seems at odds with this purpose. The only fiduciary duty involved—that owed by defendant R. Foster Winans to his employer, *The Wall Street Journal*—was not a securities-related duty but instead a duty based upon a private non-securities corporation's concern for its reputation. The party to whom Winans owed that duty—again *The Wall Street Journal*—was not a purchaser or seller of securities and had no interest in the securities purchased and sold by the defendants. Thus, the only harm involved—a potential injury to *The Wall Street Journal's* reputation for journalistic integrity—is not within the intended protection of the federal securities regulatory scheme. The information upon which the defendants traded—advance knowledge of the publication schedule of *The Wall Street Journal's* "Heard on the Street" column—was not related to the value of the securities defendants traded. In sum, neither the fiduciary duty breached, the potential injury, nor the information traded upon is within the zone of interest of the federal securities laws.

While SIA does not condone defendants' actions, the Second Circuit decision fails to appreciate that, with regard to Rule 10b-5, there may be "significant distinctions between actual legal obligations and ethical ideals" with respect to individuals and entities involved in the securities industry. SEC, Report of the Special Study of Securities Markets, H.R. Doc.

No. 95, 88th Cong., 1st Sess., 237-38 (1963). Even more troublesome, however, is the fact that the court below has extended the federal *securities* laws to cover a breach of *journalism* ethics. Predicating criminal violations for securities fraud upon breaches of business ethics—when the breach is not in itself a violation of law—is without basis in law or in public policy. By going even further and predicating securities fraud violations on a breach of ethics wholly unrelated to the securities industry, the court below has done violence to the language and purposes of Rule 10b-5.

The fact that there now exists a rule of law for securities fraud pursuant to which an employer (such as *The Wall Street Journal*) could trade on the very same information as its employees (such as Winans) *without* incurring liability cannot but cause tremendous confusion as to the scope of Rule 10b-5. Moreover, although this Court has flatly rejected the parity of information rule as contrary to the intent of the federal securities laws, *Chiarella*, 445 U.S. at 231-33, the opinion below effectively permits a private employer, because of its internal decisions on corporate policy, not only to require its employees to follow such a rule (which indeed it may do), but to determine whether its employees will be subject to criminal prosecution for securities fraud for failing to follow it (which no private entity should be allowed to do).

Information is the lifeblood of this nation's securities markets, and knowing exactly what types of information may be used in securities transactions—and when it may be so used—is crucial to the efficient operation of these markets. We agree with the dissent in *Carpenter* that Rule 10b-5 "never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper," 791 F.2d at 1037 (Miner, J., dissenting), and urge this Court to grant the petition for a writ of *certiorari* and to return Section 10(b) to its legislatively intended use.

CONCLUSION

For the reasons set forth above, SIA respectfully requests that the petition for a writ of *certiorari* be granted.

Dated: October 15, 1986

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No. 86-422

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, AND R. FOSTER WINANS,
Petitioners,
v.
UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE REPORTERS COMMITTEE FOR FREEDOM OF THE PRESS, THE NATIONAL ASSOCIATION OF BROADCASTERS, THE NEWSLETTER ASSOCIATION, THE NEW YORK FINANCIAL WRITERS ASSOCIATION, THE MEDIA INSTITUTE, THE NEWSPAPER GUILD, THE RADIO-TELEVISION NEWS DIRECTORS ASSOCIATION, THE AMERICAN SOCIETY OF MAGAZINE EDITORS, AND THE ASSOCIATED PRESS MANAGING EDITORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder authorize the prosecution of a newspaper reporter for trading secretly in securities on the basis of market-sensitive information in unpublished newspaper articles even though the reporter and his employer owe no fiduciary duty to any market participant and even though the articles when published contain no misrepresentations, are based on no inside corporate information and cause no injury to any securities investors.

2. Whether Rule 10b-5 should be construed narrowly to avoid imposing vague disclosure requirements on reporters which would interfere with the editorial processes of the print and broadcast media in violation of the First Amendment.

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Securities Exchange Act of 1984, § 10(b), 15 U.S.C. § 78j(b) .....*passim*
U.S. Const. amend. I .....*passim*

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-422

DAVID CARPENTER, KENNETH P. FELIS, AND
R. FOSTER WINANS,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF THE REPORTERS COMMITTEE FOR FREEDOM OF THE PRESS, THE NATIONAL ASSOCIATION OF BROADCASTERS, THE NEWSLETTER ASSOCIATION, THE NEW YORK FINANCIAL WRITERS ASSOCIATION, THE MEDIA INSTITUTE, THE NEWSPAPER GUILD, THE RADIO-TELEVISION NEWS DIRECTORS ASSOCIATION, THE AMERICAN SOCIETY OF MAGAZINE EDITORS, AND THE ASSOCIATED PRESS MANAGING EDITORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICI CURIAE*

The Reporters Committee for Freedom of the Press ("Reporters Committee") is a voluntary association of reporters and news editors from the print and broadcast

media. It serves as a legal defense and research fund dedicated to protecting the freedom of information rights and editorial freedom of the press guaranteed by the First Amendment. Since its founding in 1970, the Reporters Committee has taken an active role in virtually every major case concerning press freedoms before the United States Supreme Court.

The National Association of Broadcasters, organized in 1922, is a nonprofit, incorporated association of more than 4,800 radio stations, 900 television stations, and the major commercial broadcast networks. One of NAB's primary concerns is maintaining the vitality of the First Amendment guarantee of freedom of the press.

The New York Financial Writers Association is made up of over 350 reporters and editors in the New York metropolitan area who are associated with national and local print and electronic media. Founded in 1938, the Association is dedicated to upholding the professional standards of business and financial journalists and to encouraging education in this specialized field.

The Newspaper Guild is a trade union representing some 40,000 employees of newspapers, magazines, wire services and related enterprises in the United States, Canada and Puerto Rico. It has been actively involved in protecting First Amendment rights.

The Radio-Television News Directors Association is a professional association of electronic journalists. The Association has over 2,000 members who gather, edit and disseminate news and other public affairs information carried by the national networks, local radio and television broadcast stations, and cable television systems throughout the nation.

The American Society of Magazine Editors has 450 members who are chief and senior editors of consumer, trade and farm magazines across the United States. The

Media Institute is a nonprofit research organization which has published numerous reports on foreign and domestic communications policy and studies on broadcast coverage of economic news. The Newsletter Association is an international trade association of 850 publishers of 2,500 newsletters and other specialized services, which provide financial and other types of information. The Associated Press Managing Editors includes more than 600 editors of newspaper members of the Associated Press, which gathers news worldwide for dissemination to 1,350 newspapers and 3,300 broadcast stations in the United States.

Amici's membership includes reporters and editors from the field of financial journalism whose professional interests are directly affected by the theory of the government's prosecution in this case, which asserts that Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, provide a permissible vehicle for enforcing criminally and civilly undefined duties of journalists to disclose to their editors and publishers any use of their employer's confidential information that may have some effect on a securities transaction. Put another way, the prosecution in this case impermissibly attempts to criminalize journalistic codes of ethics. Failure to review petitioners' convictions thus will have a significant impact on the editorial process which is critical to the print and broadcast media's ability to report news. *Amici* are filing this brief to assist the Court by informing it of the broader public interest concerns that are implicated by this prosecution.[1] *Amici* wish to emphasize, however, that they do not condone petitioner Winan's actions, which are clearly contrary to the standards of the journalistic profession.

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[1] Pursuant to Rule 36 of the Rules of this Court, the parties have consented to the filing of this brief. Copies of those letters have been filed with the Clerk of the Court.

STATEMENT

In this case, a divided panel of the United States Court of Appeals for the Second Circuit has affirmed the conviction under the securities laws of a newspaper reporter who traded in securities in reliance on market-sensitive information contained in not-yet-published newspaper articles. Pet. App. 1a-29a. The court of appeals held that Section 10(b) of the Securities Exchange Act, and Rule 10b-5 promulgated thereunder, were violated by the reporter when he "breached a duty of confidentiality to his employer by misappropriating from the [employer] confidential prepublication information, regarding the timing and content of certain newspaper columns" and used that information in trading securities. Pet. App. 10a.

The facts of the case are set forth in detail in the opinion of the district court (Pet. App. 33a-73a) and summarized by the court of appeals. Pet. App. 5a-7a. The case centers on the actions of petitioner Winans,[2] who from August 1982 to March 1984 authored the "Heard on the Street" ("Heard") column for the *Wall Street Journal* ("*Journal*"). The Heard column consists of market gossip regarding notable volumes of trading in specific securities or price movements of various stocks. The Heard column did not rely upon or release any "inside" or confidential information, nor did the column purport to provide investment advice. However, the district court found that the column had some unquantifiable impact on the prices of the securities that were the subject of a Heard column. Pet. App. 35a-36a.

Beginning in October 1983, petitioner Winans entered into an agreement with stockbroker Peter Brandt of

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[2] Because the securities fraud convictions of petitioners Felis and Carpenter are dependent on the conviction of petitioner Winans, *amici*'s legal analysis will focus on petitioner Winans' conduct.

Kidder, Peabody & Co., Inc. ("Kidder, Peabody") to disclose the general tenor of comments—favorable or unfavorable—about specific securities and the probable publication date of upcoming columns in order to permit Brandt to trade in anticipation of the column's likely effect on the market price of the subject stocks.[3] The agreement provided that profits, if any, were to be split between Winans, Brandt and petitioner Felis, another stockbroker at Kidder, Peabody, who assisted Brandt by executing many of the trades through his personal account.[4] Petitioners traded securities on the basis of information derived from the Heard column from October 1983 until March 1984, when Winans and Carpenter, in response to an investigation by the Securities Exchange Commission ("SEC"), voluntarily went to the SEC and testified concerning their activities. Pet. App. 7a.

The courts below found that Winans' trading in securities on the basis of his knowledge of the content and publication date of upcoming Heard columns violated the *Journal*'s internal rules. Specifically, the *Journal*'s conflict of interest rules provided that knowledge of forthcoming articles was "deemed" to be the "property" of the *Journal*. The *Journal*'s internal conflict of interest rules also prohibited employees from trading in securities if they knew that an article about the securities was forthcoming in the *Journal*. Winans believed (correctly) that disclosure of his agreement with Brandt and Felis

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[3] Neither the accuracy nor the tone of any column was affected by the petitioners' scheme. The scheme was based solely on the perceived value of prepublication access to the Heard column. Pet. App. 6a-7a.

[4] Petitioner Carpenter was not directly involved in the arrangement described. However, Winans made several small prepublication trades in stocks discussed in the Heard column through a brokerage account he opened in Carpenter's name. The counts upon which Carpenter was convicted involved these securities trades. Pet. App. 38a-39a.

would result in his dismissal from the *Journal*. However, Winans testified that he did not believe that he was acting illegally. Pet. 7-8.

Following a bench trial, the district court held that petitioners Winans and Felis had entered into a conspiracy to violate the securities laws and that all three petitioners [5]—Winans, Felis and Carpenter—had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Pet. App. 3a-4a.

A divided Second Circuit affirmed the securities law convictions under the Government's theory that the petitioners had violated Section 10(b) and Rule 10b-5 when they traded on information that they had "misappropriated" from the *Journal* under the terms of the *Journal*'s conflict of interest policy. The court rejected the suggestion of *amici curiae* that such a broad theory of Rule 10b-5 liability would unnecessarily interfere with the editorial process of the print and broadcast media, thereby raising a substantial First Amendment issue. The court simply held that any restrictions on First Amendment protected activities "stem from the *Wall Street Journal* . . . company rules, not from any action by the government." Pet. App. at 22a.

REASONS FOR GRANTING THE PETITION

In this criminal prosecution, the Second Circuit has adopted a major expansion of the prohibitions of Rule 10b-5 of the securities laws. For the first time, Rule 10b-5's fundamental duty to "disclose or refrain from trading" has been held to apply to a complete market *outsider*—a person who had no access to any "inside" information and who owed no fiduciary duty to any

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[5] Brandt had pleaded guilty in a separate action; he was the Government's main witness at trial.

companies whose securities he traded. Such an expansion of liability is inconsistent with this Court's opinions in *Chiarella* v. *United States*, 445 U.S. 222 (1980) and *Dirks* v. *SEC*, 463 U.S. 646 (1983).

The Second Circuit's ruling is also worthy of review by this Court because of the First Amendment problems raised by the application of the broad "disclose or refrain" rule to a newspaper reporter who obtained nonpublic information in the course of his employment. It is important to *amici* generally, and particularly to those groups involved in financial reporting, that this Court clarify their obligations under the securities laws with respect to the publication, use and dissemination of potentially market sensitive information. Accordingly, the Court should grant the petition for a writ of certiorari.

1. To understand *amici*'s concern about the conviction in this case, it is important to realize how far removed the Second Circuit's theory is from the core concerns of Rule 10b-5's traditional prohibitions on insider trading. Obviously, the Rule's primary focus is to prohibit actual misstatements that deceive the innocent public into investing in worthless securities. But the Commission has for some time held that silence by corporate insiders who are privy to corporate secrets when they trade in the securities of their corporation is also a form of fraud prohibited by the Rule. See e.g., *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); *Chiarella* v. *United States*, 445 U.S. at 230. The Commission has, therefore, required *insiders* either (a) to disclose the corporate secrets to the other party to the transaction, so that the other party can make a fully informed decision whether or not to trade or (b) to refrain completely from trading in the affected securities. *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

The traditional "disclose or refrain" rule is derived from the special duty arising from access to inside in-

formation and from the inherent unfairness of allowing an insider to benefit from that access. 40 S.E.C. at 912 & n.15. See *Chiarella* v. *United States*, 445 U.S. at 227. The SEC has attempted, with checkered success, to extend Rule 10b-5's insider doctrine to trading by "extended insiders," *i.e.*, individuals, such as financial printers, investment bank employees or law firm employees, who in the course of their employment obtain "inside" information about corporate affairs.[6] All of these cases, while arguably stretching Rule 10b-5 to its limits, 445 U.S. at 238 (Stevens, J., concurring), nevertheless focused on the misuse of non-public, *inside* information regarding the corporations whose stocks were being traded in the securities market.

Unlike previous cases of unlawful nondisclosure, there is no evidence that petitioner Winans had any access to "inside" information about the corporations whose securities were traded.[7] More important, there is absolutely no suggestion of any fiduciary duty running from Winans or his employer, the *Journal*, to any of the corporations whose securities were traded. And the government at trial dropped an alternative theory that Winans owed some duty to the public generally under the securities laws.

As the Second Circuit recognized, under its expansion of the misappropriation theory, petitioners' conviction under the securities laws rests *solely* on a violation of

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[6] *Chiarella* v. *United States*, 445 U.S. 222 (1980); *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985); *United States* v. *Newman*, 664 F.2d 12; (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983); *SEC* v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984).

[7] "The information misappropriated here was the *Journal's* own confidential schedule of forthcoming publications. It was the advance knowledge of the timing and content of these publications, upon which [petitioners traded]." Pet. App. 17a.

Winans' ethical duty to his employer, the *Journal*. Thus, the *Journal*'s internal operating rules, which are designed to protect the *Journal*'s reputation,[8] have become the basis for a securities fraud violation and criminal sanctions. In the absence of the *Journal*'s conflict rules, which have absolutely no nexus to the securities markets, or to any purpose of the antifraud provisions of the securities laws, petitioners would not be criminally liable under Section 10(b).[9]

The Second Circuit's misappropriation theory thus conflicts with the teachings of this Court in *Chiarella* v. *United States*, 445 U.S. 222 (1980) and *Dirks* v. *SEC*, 463 U.S. 646 (1983). In *Chiarella*, this Court reversed the conviction under Section 10(b) of a financial printer who had traded on the basis of his advance knowledge of takeover bids. The Court held that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." *Id.* at 235. Such a duty arises only from a "specific relationship between two parties," and Chiarella had no relationship with any

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[8] The Court recognized that the "interest" protected under its theory was the reputational interest of the *Journal*, as reflected in its conflicts policy: "[The *Journal*'s] employees should be and are barred from destroying their employer's reputation by misappropriating their employer's informational property." Pet. App. 20a-21a. *See supra* at 8 n.7.

[9] Basing liability under the securities law solely on the breach of internal employment or ethics codes leads to several anomalous results. For example, the "sources" who provided information to Winans were free to trade on their knowledge of the upcoming publication of that material. In addition, as the Court recognized, the *Journal*'s publisher would be free to trade on the content of the Heard column. Pet. App. 20a-21a. And, at other financial publications which have no express conflicts rules, reporters may engage in precisely the same conduct as Winans without fear of prosecution under the securities laws.

of the parties from whom he purchased securities.[10] *Id.* at 233.

This Court reiterated its carefully limited interpretation of the Rule 10b-5 duty to "disclose or refrain" in *Dirks*. In that case, Dirks, a broker-dealer, received nonpublic information that because of corporate fraud the assets of an insurance company, Equity Funding, were "vastly overstated," and recommended to some of his clients that they sell their Equity Funding shares. In holding that Dirks, as a stranger to Equity Funding and its shareholders, could not be held liable directly for breaching Rule 10b-5, the Court explained that "there can be no duty to disclose where the person who has traded on inside information 'was not [the corporation's] agent, . . . was not a fiduciary [of the corporation, or] was not a person in whom the sellers [of the securities] had placed their trust and confidence.'" 463 U.S. at 654, quoting *Chiarella* v. *United States*, 445 U.S. at 232.

Thus, the holdings of this Court interpreting Section 10(b) evince a clear intent to restrict the scope of that statute—in cases of failure to disclose information—to situations where there is a breach of a fiduciary duty that can be traced to the corporation whose securities have been traded or to its shareholders.[11] Certainly, it

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[10] The Court left open the question whether Chiarella could have been convicted on the theory that his misappropriation of the information on which he based his trading breached a duty to his employer, the printing company, which, in turn, owed a duty to the acquiring company in the takeover bid. Even assuming this "misappropriation" theory were adopted, the *Journal*—unlike the printing company in *Chiarella*—owed no duty to the companies whose stock was traded by petitioners.

[11] *Amici* will not address the various issues under the mail and wire fraud statutes raised by petitioners in this case. However, if the "fraud" claim is based solely on Winans' "failure to disclose to

makes sense to limit the scope of the securities laws to correcting only those informational imbalances caused by breaches of some duty owed to a market participant. The SEC is hardly capable of ferreting out all breaches of duty to all employers simply because an employee's misconduct bears some remote connection to a securities transaction. Such matters should be handled by self-policing mechanisms within the industry. Newspapers ordinarily can uncover ethical violations and punish them effectively either by terminating employment or by using civil suits against offending employees. But, regardless of what the newspaper does, the availability of adequate alternatives to the federal securities laws argues forcefully for limiting the scope of Rule 10b-5, especially where the Congress has not spoken. *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 478 (1977) (rejecting an interpretation of Rule 10b-5 that would "bring within the Rule a wide variety of corporate conduct traditionally left to state regulation"); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 40-41 (1977).

2. The Second Circuit's unprecedented expansion of "disclose or refrain" obligations in this case is particularly troublesome to amici because it interferes with the editorial process of the print media protected by the First

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his employer that he had breached the *Journal's* private rules of confidentiality . . .," (Pet. 18) then the government's attempt to enforce this disclosure obligation under the mail and wire fraud statutes infringes the First Amendment rights of *amici* just as much as enforcement of similar requirements under the securities laws. *See infra* at 12-14.

However, even if the Court were not inclined to address the convictions under the mail and wire fraud counts, *amici* strongly urge the Court to review the securities law issues because of the adverse practical effects caused by the Second Circuit's misappropriation theory as applied to pure outsiders. *See, e.g., Ball* v. *United States*, 105 S. Ct. 1668, 1673 (1985) (this Court will review the validity of a criminal conviction, even where a reversal would not reach every count of the conviction.)

Amendment. The government is now authorized to regulate aspects of the reporter-editor relationship by enforcing vague ethical obligations of a reporter to his employer if their breach may affect securities trading—obligations which will vary with the particular code of ethics adopted by particular media organizations. Such codes of ethics are not written like criminal statutes, and their violations are not intended to result in criminal sanctions. In turn, required disclosures by reporters will certainly apply pressure on editors and publishers, in making any decision whether to publish, to take into account the possibility that publication will effectuate such a "violation" of federal law.

This type of governmental intrusion into the editorial process infringes *amici*'s First Amendment freedoms. This Court has previously recognized that the editorial process, which includes the relationship and communications between reporters and editors, is constitutionally protected from "casual inquiry" by the federal government. See *Herbert* v. *Lando*, 441 U.S. 153, 174 (1979); *Richmond Newspapers, Inc.* v. *Virginia*, 448 U.S. 555, 576 (1980) (plurality opinion); *First National Bank of Boston* v. *Bellotti*, 435 U.S. 765 (1978). The government's largely gratuitous effort, sanctioned by the district court, to impose disclosure obligations on reporters directly interferes with this process by dictating without specificity indeed with extraordinary vagueness that reporters must make unspecified disclosures to their editors. Moreover, because the disclosure requirement is derived from an inherently vague anti-fraud rule *and* from inherently vague codes of journalistic ethics (not promulgated for the purpose of defining crimes), there is a cognizable risk that *amici* and their members will be chilled in their communications and decisions as to what to write or publish by the threat of potential civil or criminal sanctions.

The disclosures required by the misappropriation theory, as applied to reporters, could well affect editors

making the decision whether an article should be published, because publication is a critical element of the securities fraud. Under the Government's theory, if the reporter discloses his prior trading to his editor, the editor's decision to proceed with publication might be held to constitute aiding and abetting of the securities violation. See *IIT* v. *Cornfeld*, 619 F.2d 909 (2d Cir. 1980). For example, the government's confused and confusing theory extends far beyond the unethical conduct of petitioner Winans. It would raise questions for an editor about whether to publish if a reporter, in order to obtain more information for a story (and for that purpose alone), had given some non-inside information obtained in news gathering to a news source who might trade in the stock. Thus, the application of the "disclose or refrain" rule in the media context implicates the core concern of the First Amendment—the prohibition of restraints on publication. See, e.g., *Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. 241, 255 (1974); *CBS* v. *Democratic National Comm.*, 412 U.S. 94, 117 (1973) (plurality opinion); *Near* v. *Minnesota*, 283 U.S. 697 (1931).

Such an adverse impact on a First Amendment protected activity can only be upheld if the Second Circuit's application of its broad "misappropriation" rule in this context is necessary to serve important governmental interests. See, e.g., *NAACP* v. *Button*, 371 U.S. 415, 438 (1963); *Smith* v. *Daily Mail Publishing Co.*, 443 U.S. 97 (1979). Here, there has not been any showing of even a substantial government interest to support this intrusion into the editorial decision-making process because it is clear that Congress had no intention of applying Section 10(b) to pure "outsiders", as this Court's decisions have demonstrated, or to aid newspapers in enforcing their code of ethics.[12]

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[12] It is ironic that this prosecution, which has been justified only in terms of protecting the *Wall Street Journal* from "misappropriation" and injury to reputation, is opposed by its supposed benefici-

Instead of addressing *amici*'s First Amendment contentions directly, the Second Circuit sidestepped the constitutional issue by arguing that the "restrictions stem from the *Wall Street Journal* . . . rules, not from any action by the government." Pet App. 22a. This logic is specious. There is a vast difference between internal ethical guidelines and federal criminal prosecutions. The government is engaging in the unprecedented practice of using existing internal codes of ethics to "make" criminal cases. The editorial process is simply not subject to government intrusion because the newspaper has its own internal guidelines regulating that process. Moreover, the government's theory results in the irrational outcome that a publisher or a reporter in a news organization without clear ethical rules may engage in conduct identical to Winans' without being subject to prosecution.

The Second Circuit's opinion creates an unprecedented basis for liability under the securities law by incorporating internal company ethics rules into the federal criminal code. In doing so, the court of appeals has disregarded the well-established rule that "ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity." *Rewis* v. *United States*, 401, U.S. 808, 872 (1971). The Second Circuit's broad construction of Section 10(b) is particularly troubling because it flies in the face of this Court's repeated admonition that statutes should be construed, if at all possible, to avoid constitutional issues. See, e.g., *Lowe* v. *SEC*, 105 S. Ct. 2557, 2563 & n.24 (1985); *NLRB* v. *Catholic Bishop of Chicago*, 440 U.S. 490, 507 (1979). The adverse impact of the court of appeals' errors on *amici* and the print and broadcast media should not be left unreviewed by this Court.

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aries, representatives of substantial segments of the print and broadcast media. The reason is simple: the media have ample ability to discipline their employees' ethical violations without invoking criminal law sanctions that threaten their ability to publish and report freely.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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IN THE

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OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and
R. FOSTER WINANS,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOINT APPENDIX

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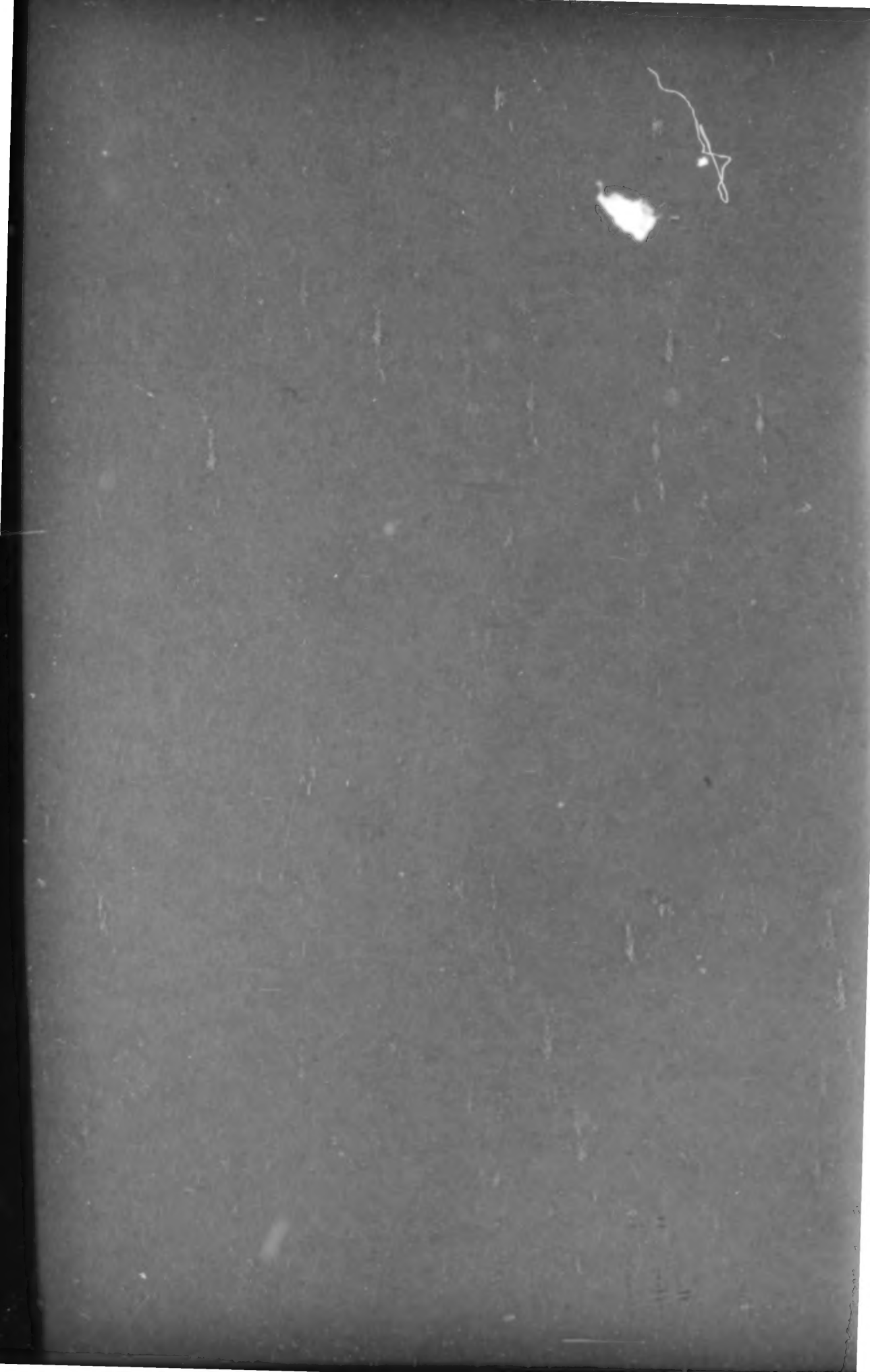

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	:	
	:	SUPERSEDING
–v–	:	INDICTMENT
	:	
R. FOSTER WINANS,	:	SS 84 Cr. 605
DAVID CARPENTER and	:	(CES)
KENNETH P. FELIS,	:	
	:	
Defendants.	:	
	:	

COUNT ONE

The Grand Jury charges:

THE DEFENDANTS

1. R. FOSTER WINANS, the defendant, at all times relevant to this Indictment up to March 28, 1984, was employed by the Wall Street Journal and its parent corporation Dow Jones & Company, Inc. at 22 Cortlandt Street, New York, New York. WINANS was assigned as one of two reporters principally responsible for the Journal's "Heard on the Street" column. WINANS also had a beneficial interest in certain bank and brokerage accounts maintained by or with DAVID CARPENTER.

2. DAVID CARPENTER, the defendant, from time to time relevant to this Indictment, maintained certain bank and stock brokerage accounts in which the defendant R. FOSTER WINANS shared a beneficial interest.

3. KENNETH P. FELIS, the defendant, at all times relevant to this Indictment, was employed as a registered representative by Kidd_r Peabody & Co., Incorporated ("Kidder Peabody") at 101 Park Avenue, New York, New York. FELIS also shares commissions and participated in a stock trading account with Peter N. Brant.

4. Peter N. Brant, named as a defendant in Information 84 Cr. 470, at all times relevant to this Indictment, was employed as a registered representative by Kidder Peabody at 101 Park Avenue, New York, New York. Brant also shared commissions and participated in a stock trading account with the defendant KENNETH P. FELIS.

THE WALL STREET JOURNAL

5. The Wall Street Journal at all times relevant to this Indictment was a newspaper published every business day by Dow Jones & Company, Inc. from editorial and publication headquarters at 22 Cortlandt Street, New York, New York. At all times relevant to this Indictment, certain of the content of Journal, including the "Heard on the Street" column, was transmitted on or about the day prior to publication by wire communication in interstate commerce from 22 Cortlandt Street, New York, New York to Chicopee, Massachusetts and Dallas, Texas for satellite transmission and printing at various locations. At all times relevant to this Information, the Journal had a circulation of approximately two million copies, including approximately 20,000 copies delivered by United States mail daily to subscribers in the Southern District of New York.

6. The "Heard on the Street" column at all times relevant to this Indictment appeared regularly in the Wall Street Journal and featured information, opinions and analyses concerning the prospects for certain industries in general and for particular companies and the securities of those companies. Readership surveys show that "Heard on the Street" is one of the most popular features in the Journal. Among stocks featured in "Heard on the Street", those mentioned favorably tend to rise in price and those mentioned unfavorably tend to decline in price on the day of publication. Because of the market sensitivity of "Heard on the Street", the Wall Street Journal

takes special measures to insure the confidentiality of the column up until the moment of publication.

THE CONSPIRACY

7. From on or about January 1, 1983, to on or about March 29, 1984, in the Southern District of New York and elsewhere, the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and others to the Grand Jury known and unknown, including Peter N. Brant, unlawfully, wilfully and knowingly, did combine, conspire, confederate and agree with and among each other to commit certain offenses against the United States, to wit: fraud in the purchase and sale of securities in violation of Title 15, United States Code, Section 78j(b) and 78ff and Rule 10b–5 thereunder, 17 C.F.R. § 240.10b–5; mail and wire fraud in violation of Title 18, United States Code, Sections 1341 and 1343; and obstruction of justice in violation of Title 18, United States Code, Section 1505.

8. It was a part of the conspiracy that the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and others to the Grand Jury known and unknown including Peter N. Brant, would and did directly and indirectly, and by use of means and instrumentalities of foreign and interstate commerce, the mails, and the facilities of national securities exchanges, (a) employ devices, schemes, and artifices to defraud, and (b) engage in acts, practices and courses of business in connection with the purchase and sale of securities, as set forth more fully below, which operated as a fraud and deceit on the Wall Street Journal and Dow Jones & Company, Inc.

9. It was further a part of the conspiracy that the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and others to the Grand Jury known and unknown including Peter N. Brant would and did devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses, representations, and promises, and that to execute the scheme, they would and did use and cause the use of the mails and wire communications in interstate commerce.

10. It was further a part of the conspiracy that the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and others to the Grand Jury known and unknown including Peter N. Brant, would and did corruptly endeavor to influence, obstruct and impede the due and proper administration of the law under which a pending proceeding was being had before a department and agency of the United States, to wit, an investigation directed by formal order of the Securities and Exchange Commission dated March 14, 1984.

OBJECTS OF THE CONSPIRACY

Among the objects of the Conspiracy were the following:

11. As a part of the conspiracy, the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and their co–conspirators agreed that WINANS would misappropriate from the Wall Street Journal and Dow Jones & Company, Inc. confidential, material, advance information which was entrusted by the Journal to WINANS by virtue of his employment concerning the subject matter, nature and timing of "Heard on the Street" columns and other articles scheduled to appear in the Journal. They agreed further that WINANS would covertly relay such information directly and indirectly to his co–conspirators. The defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and co–conspirators would and did then buy stock in anticipation of favorable articles, and sell short in anticipation of unfavorable articles, and engage in comparable transactions in options for the securities of the companies which were scheduled to be the subject of "Heard on the Street" columns and other Journal articles, for the purpose of profiting from movements in the price of those securities after publication of the stories. In so doing WINANS, with the aid and support of the defendants DAVID CARPENTER and KENNETH P. FELIS and their co–conspirators, would and did breach the trust and confidence placed in WINANS by the Wall Street Journal and Dow Jones & Company, Inc.

12. As a part of the conspiracy, the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and their co-conspirators agreed that having traded in securities in anticipation of articles scheduled to appear in the Wall Street Journal, WINANS would and did write, obtain approval for and cause to be published "Heard on the Street" columns concerning the issuers of those securities, with the expectation of profiting from movements in the price of the securities in response to the articles, and without disclosing the foregoing circumstances to the Wall Street Journal. Subsequent to the publication of the "Heard on the Street" column or other articles leaked in advance, the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and their co-conspirators would and did sell the stock which had been purchased, or purchase stock in order to cover short sales, or engage in comparable options transactions calculated to profit from price movements in the securities in response to the Journal stories.

13. As a part of the conspiracy, the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and their co-conspirators agreed to cover up and endeavor to obstruct any investigation into the scheme by attempting to disguise payments by Peter Brant and FELIS to WINANS and CARPENTER as fees for "decorating services" ostensibly rendered by CARPENTER; by making false statements to Kidder Peabody, the Wall Street Journal and officers of the Securities and Exchange Commission, and by preparing false documents intended for submission to the Securities and Exchange Commission.

14. In attempting to achieve the objects of the conspiracy, R. FOSTER WINANS, with the aid and support of the defendants DAVID CARPENTER and KENNETH P. FELIS and their co-conspirators violated his fiduciary duties owed to the Wall Street Journal and Dow Jones & Company, Inc., including a duty of honesty, loyalty and silence, a duty not to use the news pages of the Wall Street Journal for his personal benefit, a duty to report to his superiors advance leaks of stories that he knew or believed to have caused trading in securities, a duty to refrain from trading in securities based upon advance knowledge of Wall Street Journal articles, and a duty to report

to his superiors any inadvertent trading for his benefit in securities that were to be the subject of a forthcoming article.

THE MEANS OF THE CONSPIRACY

Among the means employed by the defendants and their co–conspirators to effect the conspiracy and to carry out its unlawful object were the following:

15. On or about January 10 and 11, 1983, the defendants R. FOSTER WINANS and DAVID CARPENTER caused to be purchased in a brokerage account in CARPENTER's name 400 shares of the stock of American Surgery Centers Corp. at total cost of $1,814.17. Two days later, on or about January 13, 1983, WINANS wrote and caused to be published in the Wall Street Journal a favorable "Heard on the Street" column concerning American Surgery Centers Corp. On the days that the column appeared, the closing bid price for American Surgery Centers Corp. stock rose to $5.00, or approximately $.94 over the closing bid price on the day before the column.

16. On or about March 23, 1983, the defendant R. FOSTER WINANS wrote and caused to be published a generally favorable mention of American Surgery Centers Corp. in the "Heard on the Street" column. On the day that the column appeared, the closing bid price for American Surgery Centers Corp. stock rose to approximately $7.69, or approximately $.94 over the closing bid price on the day before the column.

17. On or about May 17, 1983, the defendants R. FOSTER WINANS and DAVID CARPENTER caused to be sold from the brokerage account in CARPENTER's name the 400 shares of American Surgery Centers Corp. stock for total proceeds of $4,673.64, for a profit of $2,859.47.

18. On or about April 28, 1983, the defendants R. FOSTER WINANS and DAVID CARPENTER caused to be purchased in a brokerage account in CARPENTER's name 1,000 shares of the stock of Institutional Investors Corp. at a total cost of $1,237.50.

19. On or about June 1, 1983, the defendant R. FOSTER WINANS wrote and caused to be published in the Wall Street Journal a favorable "Heard on the Street" column concerning Institutional Investors Corp. On the day that the column appeared, the closing price for Institutional Investors Corp. stock rose to approximately $1.63, or approximately $.38 over the closing price on the day before the column. Five days later on or about June 6, 1983, WINANS and the defendant DAVID CARPENTER caused to be sold from the brokerage account in CARPENTER's name the 1,000 shares of Institutional Investors Corp. stock for total proceeds of $1735.09, for a profit of $497.59.

20. In or about mid-1983, at a meeting at the Racquet & Tennis Club in Manhattan, the defendant R. FOSTER WINANS and Peter N. Brant discussed among other things the effect of the "Heard on the Street" column on the market price of securities.

21. On or about Sunday, October 16, 1983, during a discussion on a golf course on Long Island, the defendant R. FOSTER WINANS and Peter N. Brant agreed that WINANS would systematically disclose to Brant confidential advance information concerning the subject matter, nature and timing of "Heard on the Street" columns, in order for Brant to execute transactions in the securities or options for the securities of companies to be featured in the stories. WINANS and Brant agreed to share profits from such trading. Brant agreed to advance $15,000 to WINANS disguised in the form of a check payable to the defendant DAVID CARPENTER. On or about the same day, Brant advised the defendant KENNETH P. FELIS of the agreement.

22. On or about Monday, October 17, 1983, Peter N. Brant wrote a $15,000 check payable to DAVID CARPENTER and caused it to be delivered to the defendant R. FOSTER WINANS. On or about the same day, WINANS informed Brant the a generally favorable article concerning oil-service companies, including Schlumberger, Ltd., would appear in "Heard on the Street" on the following day. As a result of this conversation, Brant purchased common stock and call options for Schlumberger, Ltd. in accounts in the names of Brant and the defendant KENNETH P. FELIS at Kidder Peabody. Later on the same day, WINANS advised Brant that the column in question had been delayed until Wednesday, October 19, 1983. On or about Wednesday, October 19, 1983, the "Heard on the Street" column concerning Schlumberger, Ltd., and other oil-service companies appeared in the Wall Street Journal.

23. Over the next four and one-half months, the defendant R. FOSTER WINANS leaked advance information concerning approximately two dozen additional articles written by himself and others directly or indirectly to one or more of the defendants KENNETH P. FELIS and DAVID CARPENTER and to Peter N. Brant and others who caused securities to be purchased and sold on the basis of this information. In all, the conspirators gained illegal gross profits of approximately $900,000 at the expense of public investors, and also realized trading losses of approximately $225,000 as a result of this trading.

24. In or about the latter part of October, 1983, the defendants R. FOSTER WINANS and KENNETH P. FELIS and Peter N. Brant met on one or more occasions in Manhattan at the Racquet & Tennis Club, Nicola's Restaurant and elsewhere in order to introduce WINANS and FELIS, and to discuss various aspects of the scheme.

25. On or about Thursday, November 3, 1983, after approximately eleven stocks had been traded in accounts maintained in the names of the defendant KENNETH P. FELIS and another on the day before they appeared in "Heard on the Street", Kidder Peabody questioned FELIS and Peter N. Brant about the coincidence. Brant and FELIS falsely stated that

FELIS were merely mimicking trades initiated by one of Brant's customers, and that he had the customer's permission to engage in this practice. Kidder Peabody instructed Brant and FELIS that such trading in FELIS' account was to stop.

26. On or about the same day, the defendant KENNETH P. FELIS and Peter N. Brant decided to continue their trading through a Swiss bank. Brant contacted the Bank Institute of Zurich, through which he had previously done business on behalf of a customer, and discussed the use of "Western Hemisphere Trading Corporation," a Costa Rican corporation, in order to conduct the trading. On or about the following day, Friday, November 4, 1983, FELIS and Brant withdrew $275,000 from the account which they maintained in FELIS' name at Kidder Peabody and converted those funds into a bank check payable to Western Hemisphere Trading Corp.

27. On or about Saturday, November 5, 1983, the defendant KENNETH P. FELIS arrived in Spain on a pre-arranged vacation. In or about the following week, FELIS travelled to Switzerland and visited the Bank Institute of Zurich, where he deposited the $275,000 check. FELIS also arranged to "rent" the use of "Western Hemisphere Trading Corporation" for $1500 per month. FELIS then arranged for $250,000 to be wired back to Kidder Peabody in New York to fund the "Western Hemisphere Trading Corp. Account Number 2," and left $25,000 on deposit with the Bank Institute of Zurich on account of monthly fees.

28. On or about Thursday, November 10, 1983, Peter N. Brant gave the defendant R. FOSTER WINANS approximately $1,000 in British pounds as a portion of WINANS' share of the proceeds of the scheme, to be used by the defendant DAVID CARPENTER on a forthcoming trip to England.

29. On or about Thursday, December 1, 1983 and on four more occasions thereafter, the defendant KENNETH P. FELIS and Peter N. Brant resumed using information received from the defendant R. FOSTER WINANS to trade in securities in the name of Western Hemisphere Trading Corp. Account No. 2. On or about December 5, 1983, $250,000 was

wire transferred from the Bank Institute of Zurich to Kidder Peabody in New York to fund this trading.

30. On or about Wednesday, December 7, 1983, the defendant R. FOSTER WINANS met Peter N. Brant at the Polo Lounge at the Westbury Hotel in Manhattan and received a $5000 check from Brant payable to the defendant DAVID CARPENTER as a further payment of WINANS' share of the proceeds of the scheme. On or about the following day, the check was deposited to a joint checking account maintained by WINANS and CARPENTER.

31. In or about mid-January, 1984, Peter N. Brant advised the defendant R. FOSTER WINANS in substance that losses due to a recent price drop in the stock of Digital Switch Corp., a stock in which Brant was heavily invested, were restricting the ability of the conspirators to conduct further trading. Brant further advised WINANS that if he were able to sell his Digital Switch stock at a favorable price, the conspirators' volume of trading could increase. Brant also suggested to WINANS the basis for a favorable story about Digital Switch. On January 19, 1984, WINANS caused to be published a favorable "Heard on the Street" column concerning Digital Switch. Later on the same day, Brant caused 25,000 shares of Digital Switch to be sold at an average price of approximately $32 per share from two accounts which were maintained at Kidder Peabody in the name of a customer and in which Brant had a profit-sharing interest. These sales after publication of WINANS' article resulted in a profit of approximately $11,250 over the previous day's closing price for Digital Switch.

32. On or about January 29, 1984, the defendant KENNETH P. FELIS wrote a $10,000 check payable to the defendant DAVID CARPENTER, which Peter N. Brant subsequently delivered to the defendant R. FOSTER WINANS as a further payment in connection with the scheme. Pursuant to an understanding among the conspirators, the word "drapes" was noted on the check in order to support the false explanation that the payment was in return for interior decorating services rendered by CARPENTER.

33. At approximately 4:40 p.m. on Thursday, March 1, 1984, the defendant R. FOSTER WINANS was interviewed by telephone by staff members of the Securities and Exchange Commission.

34. Later on or about Thursday, March 1, 1984, the defendant DAVID CARPENTER, acting as a "go-between" for the defendant R. FOSTER WINANS, telephoned Peter N. Brant and in a coded conversation asked to meet with Brant. CARPENTER and Brant met later the same night at Brant's Manhattan apartment and discussed the SEC's questions and WINANS' responses as well as the false explanation for the checks payable to CARPENTER in return for "decorating services."

35. Beginning on or about Saturday, March 3, 1984 and on a number of occasions over the next two and one-half weeks, the defendant DAVID CARPENTER met with Peter N. Brant and occasionally with the defendant KENNETH P. FELIS at Brant's home on Long Island, at Brant's apartment in Manhattan, and at a number of other locations in Manhattan, to discuss the course of the investigation, the false cover story, and the preparation by CARPENTER of false invoices for "decorating services" to account for the payments from Brant and FELIS. On or about March 22, 1984, CARPENTER delivered three such invoices to Brant and FELIS.

36. On or about the evening of Wednesday, March 21, 1984, the defendants R. FOSTER WINANS, KENNETH P. FELIS and DAVID CARPENTER and Peter N. Brant met at Trader Vic's at the Plaza Hotel in Manhattan to review the course of the SEC investigation and the false cover story.

OVERT ACTS

In furtherance of the conspiracy and to effect its objects, the following overt acts, among others, were committed in the Southern District of New York:

37(a)–37(v). On or about the day before each "date of publication" in each of the overt acts (a) through (v) below, the defendant R. FOSTER WINANS wrote or contributed to "Heard on the Street" columns or other articles concerning the "subject" listed:

	DATE OF PUBLICATION	SUBJECT
(a)	1/13/83	American Surgery Centers Corp.
(b)	3/23/83	American Surgery Centers Corp.
(c)	6/1/83	Institutional Investors Corp.
(d)	10/19/83	Schlumberger Ltd.
(e)	10/20/83	TIE/Communications, Inc.
(f)	10/21/83	Merrill Lynch & Co.
(g)	10/25/83	Key Pharmaceuticals, Inc.
(h)	10/28/83	Todd Shipyards Corp.
(i)	10/31/83	Charter Co.
(j)	11/1/83	Toys "R" Us, Inc.
(k)	11/2/83	International Paper Co.
(l)	11/9/83	Western Union Corp.
(m)	11/17/83	Coleco Industries Inc.
(n)	12/6/83	Petro–Lewis Corp.
(o)	12/12/83	G.D. Searle & Co.
(p)	2/3/84	Merrill Lynch & Co.

	DATE OF PUBLICATION	SUBJECT
(q)	2/14/84	Quotron Systems Inc.
(r)	2/15/84	Isomedix, Inc.
(s)	2/15/84	Radiation Technology, Inc.
(t)	2/17/84	Beatrice Foods Co.
(u)	2/22/84	Kaypro Corp.
(v)	2/27/84	Chicago Milwaukee Corp.

(Title 18, United States Code, Section 371.)

COUNTS TWO THROUGH TWENTY-FIVE

The Grand Jury further charges:

38. On or about the dates indicated in Counts Two through Twenty-Five below, in the Southern District of New York, the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS as indicated in the "Defendants Charged" column below and with respect to the counts in which their names are listed, unlawfully, wilfully and knowingly, directly and indirectly, and by use of means and instrumentalities of foreign and interstate commerce, the mails, and the facilities of national securities exchanges, did (a) employ devices, schemes, and artifices to defraud, and (b) engage in acts, practices and courses of business, which operated as a fraud and deceit on the Wall Street Journal and Dow Jones & Company, Inc., in connection with the purchase and sale of securities, including the following:

COUNT	SUBJECT COMPANY	APPROX-IMATE DATE OF TRANSAC-TIONS	NUMBER OF SHARES/ OPTIONS BOUGHT (SOLD)	DEFENDANTS CHARGED
2	Schlumberger, Ltd.	10/17/83	15,000 Shares 100 Calls	Winans/Felis
3	TIE/Communications, Inc.	10/19/83	454 Puts	Winans/Felis
4	Merrill Lynch & Co., Inc.	10/20/83	543 Puts	Winans/Felis
5	Key Pharmaceuticals, Inc.	10/24/83	232 Puts	Winans/Felis
6	International Harvester Co.	10/25/83	20,000 Shares	Winans/Felis
7	Commodore/International Ltd.	10/27/83	300 Puts	Winans/Felis
8	Todd Shipyards Corp.	10/27/83	5,000 Shares	Winans/Felis
9	Charter Co.	10/27/83	346 Puts	Winans/Felis
10	Toys "R" Us, Inc.	10/31/83	15,000 Shares	Winans/Felis
11	International Paper Co.	11/1/83	(10,000 Shares) 100 Puts	Winans/Felis
12	Perkin-Elmer Corp.	11/2/83	20,000 Shares 8 Calls	Winans/Felis
13	Petro-Lewis Corp.	12/1/83	20,000 Shares	Winans/Felis
14	Rolm Corp.	12/2/83	20 Puts	Winans/Carpenter
15	G. D. Searle & Co.	12/9/83	82 Puts 20 Puts	Winans/Felis
16	Greyhound Corp.	12/9/83	522 Calls	Winans/Felis
17	Greyhound Corp.	12/9/83	15 Calls	Winans/Carpenter
18	Merrill Lynch & Co., Inc.	2/2/84	15 Puts	Winans/Carpenter
19	Quotron Systems, Inc.	2/3/84	(10,000 Shares)	Winans/Felis
20	Quotron Systems, Inc.	2/10/84-2/11/84	(1,500 Shares)	Winans/Felis
21	Browning-Ferris Industries, Inc.	2/14/84	5 Puts	Winans/Carpenter

COUNT	SUBJECT COMPANY	APPROX-IMATE DATE OF TRANSAC-TIONS	NUMBER OF SHARES/ OPTIONS BOUGHT (SOLD)	DEFENDANTS CHARGED
22	Beatrice Foods Co.	2/16/84	15 Calls	Winans/Carpenter
23	Beatrice Foods Co.	2/16/84	40 Calls	Winans/Felis
24	Kaypro Corp.	2/21/84	200 Shares	Winans/Carpenter
25	Chicago Milwaukee Corp.	2/16/84	800 Shares	Winans/Felis

39. The allegations contained in all the preceding paragraphs of Count One of this Indictment are repeated and realleged as though fully set forth herein and as constituting and describing part of the scheme by which the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS committed the offenses charged in Counts Two through Twenty–Five.

(Title 15, United States Code, Sections 78j(b) and 78ff, Rule 10b–5 [17 C.F.R. § 240.10b–5] and Title 18, United States Code, Section 2).

COUNTS TWENTY–SIX THROUGH FORTY–THREE

The Grand Jury further charges:

40. From on or about January 1, 1983, up to and including March 29, 1984, in the Southern District of New York and elsewhere, R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS, the defendants, and others to the Grand Jury known and unknown, did unlawfully, wilfully and knowingly devise and intend to devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses, representations, and promises as alleged in paragraphs one through thirty–six above.

41. On or about the day before the "Date of Publication" set forth below, in the Southern District of New York, R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS, the defendants, as indicated below in the "Defendants Charged" column and with respect to the counts below in which their names are listed, unlawfully, wilfully and knowingly, for the purpose of executing said scheme and artifice did cause to be transmitted by means of wire and radio and television communication in interstate commerce writings, signs and signals; to wit, "Heard on the Street" columns or other articles written in whole or in part by WINANS concerning the "subject(s)" set forth below, transmitted from the Wall Street Journal at 22 Cortlandt Street, New York, New York, to Chicopee, Massachusetts, for printing and re–transmission by satellite:

COUNT	DATE OF PUBLI–CATION	SUBJECT(S)	DEFENDANTS CHARGED
26	10/19/83	Schlumberger, Ltd.	Winans/Felis
27	10/20/83	TIE/Communications, Inc.	Winans/Felis
28	10/21/83	Merrill Lynch & Co.	Winans/Felis
29	10/25/83	Key Pharmaceuticals, Inc.	Winans/Felis
30	10/28/83	Todd Shipyards Corp.	Winans/Felis
31	10/31/83	Charter Co.	Winans/Felis
32	11/1/83	Toys "R" Us, Inc.	Winans/Felis
33	11/2/83	International Paper Co.	Winans/Felis
34	11/9/83	Western Union Corp.	Winans
35	11/17/83	Coleco Industries, Inc.	Winans
36	12/6/83	Petro–Lewis Corp.	Winans/Felis

COUNT	DATE OF PUBLI-CATION	SUBJECT(S)	DEFENDANTS CHARGED
37	12/12/83	G. D. Searle & Co.	Winans/Felis
38	2/3/84	Merrill Lynch & Co.	Winans/Carpenter
39	2/14/84	Quotron Systems Inc.	Winans/Felis
40	2/15/84	Isomedix, Inc. Radiation Technology, Inc.	Winans/Carpenter/ Felis
41	2/17/84	Beatrice Foods Co.	Winans/Carpenter/Felis
42	2/22/84	Kaypro Corp.	Winans/Carpenter
43	2/27/84	Chicago Milwaukee Corp.	Winans/Felis

42. The allegations contained in all the preceding paragraphs of Count One of this Indictment are repeated and realleged as though fully set forth herein and as constituting and describing part of the scheme by which the defendants R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS and others committed the offenses charged in these Counts.

(Title 18, United States Code, Sections 1343 and 2.)

COUNTS FORTY-FOUR THROUGH SIXTY-ONE

The Grand Jury further charges:

43. From on or about January 1, 1983, up to and including March 29, 1984, in the Southern District of New York and elsewhere, R. FOSTER WINANS, DAVID CARPENTER and KENNETH P. FELIS, the defendants, and others to the Grand Jury known and unknown, did unlawfully, wilfully and knowingly devise and intend to devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses, representations, and promises as alleged in paragraphs one through thirty-six above.

44. On or about the dates set forth below, in the Southern District of New York, R. FOSTER WINANS, DAVID CARPENTER and KENNETH FELIS, the defendants, as indicated below in the "Defendants Charged" column and with respect to the counts below in which their names are listed, unlawfully, wilfully and knowingly, for the purpose of executing said scheme and artifice and attempting to do so, did cause to be placed in post offices and authorized depositories for mail matter, and did cause to be delivered by the United States Postal Service according to the directions thereon, mail matter and things, to wit, approximately 20,000 copies delivered in the Southern District of New York of the Wall Street Journal including "Heard on the Street" columns or other articles written in whole or in part by WINANS concerning the "subjects" set forth below:

COUNT	APPROX-IMATE DATE	SUBJECT(S)	DEFENDANTS CHARGED
44	10/19/83	Schlumberger, Ltd.	Winans/Felis
45	10/20/83	TIE/Communications, Inc.	Winans/Felis
46	10/21/83	Merrill Lynch & Co.	Winans/Felis
47	10/25/83	Key Pharmaceuticals, Inc.	Winans/Felis
48	10/28/83	Todd Shipyards Corp.	Winans/Felis
49	10/31/83	Charter Co.	Winans/Felis
50	11/1/83	Toys "R" Us, Inc.	Winans/Felis
51	11/2/83	International Paper Co.	Winans/Felis
52	11/9/83	Western Union Corp.	Winans
53	11/17/83	Coleco Industries, Inc.	Winans
54	12/6/83	Petro-Lewis Corp.	Winans/Felis
55	12/12/83	G. D. Searle & Co.	Winans/Felis
56	2/3/84	Merrill Lynch & Co.	Winans/Carpenter
57	2/14/63	Quotron Systems Inc.	Winans/Felis
58	2/15/84	Isomedix, Inc. Radiation Technology, Inc.	Winans/Carpenter/ Felis
59	2/17/84	Beatrice Foods Co.	Winans/Carpenter/Felis
60	2/22/84	Kaypro Corp.	Winans/Carpenter
61	2/27/84	Chicago Milwaukee Corp.	Winans/Felis

45. The allegations contained in all the preceding paragraphs of Count One of this Indictment are repeated and realleged as though fully set forth herein and as constituting and describing part of the scheme by which the defendants R. FOSTER WINANS, DAVID CARPENTER, and KENNETH P. FELIS committed the offenses charged in these Counts.

(Title 18, United States Code, Sections 1341 and 2.)

FOREMAN

WILLIAM M. TENDY
Acting United States
Attorney

EXH. W-D

CHART OF INDICTMENT CHARGES RELATED TO DAVID CARPENTER SCHWAB ACCOUNT TRANSACTIONS

Count	Security	Date, Type and Price of Purchase	Date of WSJ Articles	Date and Price of Sale	Profit
14	Rolm Corp.	12/2/83 20 Dec. 50 puts $ 690.00	12/5/83	12/5/83 20 Dec. 50 puts $1,434.95	$ 744.95
17	Greyhound Corp.	12/9/83 15 Jan. 25 calls $ 992.50	12/13/83	12/13/83 15 Jan. 25 calls $2,379.91	$1,387.41
18 38 56	Merrill Lynch	2/2/84 15 Apr. 25 puts $ 617.50	2/3/84	2/3/84 15 Apr. 25 puts $ 788.72	$ 171.22
21	Browning-Ferris	2/14/84 5 Mar. 35 puts $ 691.25	2/15/84	2/15/84 5 Mar. 35 puts $ 963.96	$ 272.71
22 41 59	Beatrice Foods	2/16/84 15 Mar. 35 calls $1,086.25	2/16/84 & 2/17/84	2/17/84 15 Mar. 35 calls $2,658.90	$1,572.65
24 42 60	Kaypro Corp.	2/21/84 200 shs. common $1,283.00	2/22/84	2/24/84 200 shs. common $1,636.90	$ 353.90
					$4,502.84

EXH. W-E

CHART OF PROFITS AND LOSSES SUSTAINED IN SECURITIES TRANSACTIONS CHARGED IN THE INDICTMENT

Count	Positive Opening Transaction	Negative Opening Transaction	Profit	Loss
2	Schlumberger			($47,464.78)
3		TIE	$ 51,150.26	
4		Merrill	16,706.58	
5		Key	52,169.19	
6	Int'l Harvester		9,241.32	
7		Commodore	87,519.55	
8	Todd		10,731.25	
9		Charter	34,761.43	
10	Toys 'R' Us		4,118.25	
11		Int'l Paper	14,382.45	
12	Perkins-Elmer		21,453.52	
13	Petro-Lewis			($16,420.15)
14		Rolm	744.95	
15		Searle	6,953.24	[+ 1,259.59]
16	Greyhound			($49,567.60)
17	Greyhound		1,387.41	
18		Merrill	171.22	
19		Quotron	10,000.00	
20		Quotron		[+ 1,444.50]
21		Browning-Ferris	272.71	
22	Beatrice		1,572.65	
23	Beatrice			[+ 2,516.32]
24	Kaypro		353.90	
25	Chicago-Milwaukee			($ 2,742.29)
			$323,689.88	$116,194.82

EXH. W-F

CHART OF THOSE TRANSACTIONS CHARGED IN THE INDICTMENT IN WHICH LOSSES WERE SUSTAINED

Count	Securities	Opening Transaction Date	Securities Acquired (Amount, Type, Cost)	Closing Transaction Date	Securities Sold (Amount, Type, Cost)	Loss
2	Schlumberger	10/17/83	15,000 shs.	10/19/83	15,000 common sold	
			$838,887.50		$800,973.25	($37,914.25)
		10/17/83	100 Nov. 55 calls	10/19/83	15 Nov. 55 calls sold	
				10/20/83	85 Nov. 55 calls sold	
			$ 25,012.50		$ 15,461.97	($ 9,550.53)
13	Petro-Lewis Corp.	12/1/83	20,000 shs.	12/6/83	5,000 common sold	
				12/9/83	15,000 common sold	
			$241,000.00		$224,579.85	($16,420.15)
16	Greybound Corp.	12/9/83	500 Jan. 25 calls bought	1/21/84	500 Jan. 25 calls expired	
			22 Jan. 20 calls bougi..	1/17/84	22 Jan. 20 calls sold	
			$ 58,756.50		$ 9,188.90	($49,567.60)
25	Chicago-Milwaukee Corp.	2/16/84	800 shs.	3/7/84	800 common sold	
			$ 93,244.62		$ 90,502.33	($ 2,742.29)

EXH. W-M

March 27, 1973

Dow Jones Policy on Securities

Transactions by our Staff

We want to make sure that every employee is aware of our policy on securities transactions and that he follows it strictly.

The staffs of our publications and news services have access to inside information, and the stories we print in many cases affect the securities prices of individual companies and, sometimes, whole industries. Thus, for a starter—and it is only a starter—we are obligated to comply with the regulations governing insider trading.

The federal securities laws prohibit anyone possessing inside information from trading in the affected securities until the information is available to the public.

The leading case of *SEC v. Texas Gulf Sulphur* applied the following standard:

> "Anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed."

But we want to do more than just satisfy the regulations. We expect each staff member to bend over backwards to avoid any action, no matter how well intentioned, that could provide grounds even for suspicion:

(1) That he made financial gains by acting on the basis of "inside" information obtained through his position on our staff, before it was available to the general public. Such information includes hold-for-release material and our plans for running Dow Jonesers and other stories and items that may affect price movements. (2) That his writing of a Dow Joneser or other news story or item was influenced by a desire to affect the stock's price. (3) That he is financially committed in the market so deeply or in such other ways as to create a temptation to biased writing. (4) That he is indebted to brokers or some other group we cover. Such indebtedness could arise through acceptance of favors, gifts or payments for performing writing assignments or other services for them. Or (5) That he is beholden for any tips, allocations of underwritten new issues or in any other way to anyone in the financial community.

While we do not want to penalize our staff by suggesting that they do not buy stocks or make other investments, we want to reiterate that it is not enough that everyone be incorruptible and act with honest motives. It is equally important that they use good judgment and conduct their outside activities so that no one—our editors, an SEC

investigator with power of subpoena, or a political critic of the company—has any grounds for even raising the suspicion that a staff member misused his position with the company.

It is important for all members of our staff to keep in mind the tremendous embarrassment and damage to the company's reputation that could come about through a lapse in judgment by one man, no matter how well intentioned he may be. Because we think it so essential that every member of our staff be above suspicion, we consider any slip in judgement in this area serious enough to warrant dismissal.

With the foregoing general propositions in mind, we ask every employee to follow these specific guidelines:

A. First and foremost, all material gleaned by you in the course of your work for Dow Jones is deemed to be strictly the company's property. This includes not only the fruits of your own and your colleagues' work, but also information on plans for running items and articles on particular companies and industries in future issues. Such material must never be disclosed to anyone outside the company, including friends and relatives. Viewing information as the company's property should avoid a great many of the obvious pitfalls.

B. No staff member regularly assigned to a specific industry should invest in any company engaged in whole or significant part in that industry.

C. No staff member with knowledge of an upcoming article or item concerning a company or industry should, prior to the publication of such article or item, invest in such company or companies in such industry; nor, if he already owns any such security, should he sell it prior to publication without the approval of the Managing Editor.

D. We ask further that any staff member having prior knowledge of an upcoming article or item delay his trading in the securities of the companies involved until the general public has an opportunity to read and digest the information contained in any Dow Jones publication.

E. If a staff member should inadvertently buy or sell a security or otherwise invest contrary to the guidelines set forth in C or D, or if he should buy a security prior to publication, and then acquire knowledge of a proposed article or item, he should notify the Managing Editor as soon as practical, and in the case of a purchase hold the security for 6 months.

F. No staff member should engage in short selling of securities.

Ed Cony
Executive Editor

Addendum to the March 27, 1973 Policy

On Securities Transactions by our Staff

Some of us have been bothered by the ambiguity of Guideline D. It asks that staff members having prior knowledge of a story delay buying or selling the securities of any companies involved until the general public has had an opportunity to read and digest the story. But just how long should the delay be?

We ask that you wait two full trading days after an article first appears in a Dow Jones publication or news service. For instance, if a story ran Friday noon on the Dow Jones News Service, no staffer should trade any security whose price is apt to be affected by that story before the next Tuesday noon. In the case of Barron's, there should be no trading before the opening of the market on Wednesday (the current rule on Barron's).

If a story appears first on the ticker and then in the Journal, the 48-hour clock begins to run as soon as the ticker story is out.

Ed Cony
4/6/73

EXH. W-Q

ALL CITIES: December 20, 1984

TO THE STAFF:

We wish you and your families a joyous holiday season, a very Merry Christmas and a New Year that is full of happiness and good health.

The company's directors and all of our associates in management join us in that wish, and in thanking you for making this past year another successful one for Dow Jones.

Our publications and services continued to grow and to improve. Recognition of this is reflected in Fortune Magazine's Latest Survey of Corporate Reputations published in its issue dated January 7. It shows Dow Jones ranked No. 1 in quality of products for the second consecutive year.

To help brighten the holidays for those less fortunate than ourselves, and in lieu of some of our past Christmas festivities, the company is adding to its traditional year-end charitable contributions a special $50,000 donation, made in the name of Dow Jones' employees, to the Child Welfare League of America. This is the third year that we have done this.

Our 1984 gains were achieved through your efforts. We are confident that with your help 1985 will be another year of progress.

Happy Holidays and

All the Best,
Warren Phillips and Ray Shaw

WALL STREET JOURNAL, FEBRUARY 27, 1984

SEC Probe of Searle Options Raises Questions on Ethics, Inside Trades

(by Bruce Ingersoll)

Washington — Viewers of CBS Evening News last month saw Arizona scientist Woodrow Monte challenge the saftey of NutraSweet, the low–calorie sweetener made by G.D. Searle and Co., as part of a three–part report that raised questions about the product.

What the viewers didn't know was that Mr. Monte had bought "put" options on Searle stock just a few weeks before the report was aired. So did his Phoenix lawyer, Richard Faerber. They concede was that they bought the options because they expected Searle stock to fall as a result of the adverse publicity.

As it turned out, they lost money because Searle's stock didn't fall as much as they had expected. But the trading raises difficult ethical questions and questions about what constitutes illegal insider trading.

Messrs. Monte and Faerber defend their actions. "I honestly believe I had a right to do it," Mr. Monte says. "Gosh, I'm an American citizen. I don't feel its unethical. It's the American way."

As for the trading, Mr. Faerber says: "I am not ashamed or sorry about what I did. I don't think it was illegal."

The Securities and Exchange Commission may disagree. It is investigating a highly unusual series of upsurges in Searle options trading from Nov. 22 until the network presented the NutraSweet series on Jan. 16, 17 and 18. SEC investigators are focusing on a group of people, including Arizona investors and CBS employees, who were in a position to know the series was in the works and could have profited from buying put options on Searle's stock.

A put is an option contract that gives the buyer the right to sell 100 shares of a given stock at a certain price within a specified period of time. If the stock drops in price, a put buyer makes money.

The SEC could have trouble making an insider–trading case against Messrs. Monte and Faerber, according to Bevis Longstreth, a former SEC commissioner. The reason: The information on which they traded didn't come from inside any company to whose shareholders they had a fiduciary responsibility.

Mr. Monte, director of Arizona State University's Food Sciences and Research Laboratory, and Mr. Faerber insist that they were relying on the same kind of public information that Wall Street analysts and institutional investors use.

At CBS News, the legal question could turn on whether any employees "misappropriated" private information entrusted to them — specifically, plans to televise a series that could alarm consumers and bother Searle's stock. But Mr. Longstreth believes the SEC would face an "uphill fight" trying to prove insider–trading violations on that basis.

Gene Master, a CBS News vice president, says the SEC has indicated to the network's lawyers that subpoenas would be issued to some CBS employees, "but I don't know when, how many, or to whom."

In Skokie, Ill., William Greener, a spokesman for Searle, says, "We have no indication that any Searle employees are involved." He says he doesn't know of any impending subpoenas for Searle employees.

Mr. Greener says the drug and food–products company learned of the investigation Jan. 27 when an SEC investigator called to ask whether Searle had ever financed the research of Mr. Monte. Searle said it hadn't, and informed the investigator that the scientist was one of NutraSweet's critics. The investigator, in checking out his list of names, was also told that he had Mr. Faerber's name misspelled, Mr. Greener says.

Mr. Faerber says the passion of Mr. Monte's scientific convictions prompted him to join the anti–NutraSweet camp as a pro bono lawyer. "The guy couldn't sleep at night," he says. One of Mr. Monte's main concerns is that aspartame, the generic name for NutraSweet, breaks down into potentially toxic methyl alcohol, particularly when diet soft drinks are stored at high temperatures. Neither Searle nor the Food and Drug Administration sees this as a health threat.

"We don't know what a small amount of methyl alcohol will do over a long time," Mr. Monte said on the CBS Evening News program. He and the National Dietetic Association made the same argument in petitioning the Arizona Department of Health Services to ban the sale of aspartame–sweetened beverages and in asking the FDA to hold hearings. Mr. Faerber is also the lawyer for the dietetic association.

Taking on a corporate giant like Searle, however, takes money. Mr. Monte and Mr. Faerber say they were investing neophytes, but decided to try trading in Searle put contracts. "I felt the CBS report, if they went with it, would have an impact," Mr. Monte says.

That feeling was reinforced by what Mr. Faerber was hearing from securities analysts who follow Searle. "I did tell some of them a network had interviewed Dr. Monte," he says. "One guy's response was, 'Boy, this will kill the stock.' What's so wierd, it didn't. This stock went up every day the program was aired."

Searle's stock peaked at $54,625 on Nov. 25 and then began a gradual slide to the low $40s by early January, but it didn't fall far enough for the investors to profit. The company's stock closed Friday on the New York Stock Exchange at $46.25 a share.

Mr. Monte says he invested $1,904 in Searle puts and lost $1,224. Mr. Faerber says he and two friends invested $2,000 to $5,000 each during December and early January, and also incurred losses.

"On the bottom line, what we were doing is betting we would succeed with our FDA and Arizona petitions," Mr. Faerber says. "It certainly was a wrong bet, because we haven't succeeded yet."

What they did is "sleezy," says Michael F. Jacobson, executive director of the Center for Science in the Public Interest. "Outrageous," says Dr. Sidney Wolfe, director of Public Citizens' Health Research Group. "That kind of behavior is unethical."

"If I get a phone call from Wall Street analysts asking about something we're working on before it's public, I refuse to give them any information," Dr. Wolfe says.

Mr. Monte insists his actions weren't unethical. "If any money was made, it was to go toward fighting the (NutraSweet) battle," he says. Mr. Faerber says he only regrets handing Searle "on a silver platter" a chance to impugn the motives of his scientific adversaries.

CBS News says it is aiding the SEC investigation of possible trading by some of its employees. Whatever the legalities, the use of inside CBS information for private gain would violate the news division's ethics standards, says Mr. Mater, the CBS News vice president. "Bear in mind," Mr. Mater says, "it is our interest to find out what the hell happened. We have a reputation at stake."

The network, however, hasn't begun an internal inquiry. "One, where do you begin something like that," Mr. Mater says. "Two, we'd be stepping on the toes of those who do know what to do."

WALL STREET JOURNAL, MARCH 2, 1984

Media Policies Vary on Preventing Employees and Others From Profiting on Knowledge of Future Business Stories

When new financial reporters start work at the Philadelphia Inquirer, business editor Larry Williams sits down with them to answer their questions — and to pose one of his own. "Right in between 'Should I get Blue Cross–Blue Shield?' and 'What are my days off?' comes 'What are you investing in?'" he says.

The reason is that the Inquirer has formal guidelines designed to prevent journalists from trading in stock based on their inside knowledge of future news reports. Some other newspapers, magazines and television news operations have tough standards, too: Forbes and the Chicago Tribune, for example, both require editorial employees to regularly file forms listing their investments.

But that's the exception. An informal survey of the media around the country shows that many have informal policies or none at all. "There are certain things you assume people won't do," says David Hopcraft, executive editor of the Cleveland Plain Dealer. James Toms, business editor of the Akron Beacon Journal, says that reporters who traded in a company's stock while writing a story about the firm "might get transferred off the business page." And the Tulsa World has written guidelines about how reporters should dress, but no formal rules about stock trading.

In addition, the media generally seem unconcerned about the additional ethical issues raised by the case of G.D. Searle & Co. and the CBS Evening News. An Arizona scientist, interviewed by CBS for an investigative report on Searle's new sweetener, bought "put" options in Searle stock before the story aired, betting that the stock would go down because of negative comments from himself and others. The Securities and Exchange Commission is investigating whether CBS employees also bought Searle options.

The questions for the media are how to prevent the subjects of interviews from trading in securities based on their expectation of a positive or negative news report; by extension, how to avoid the possibility that securities analysts or others will disclose

information about a company because they have positions in the stock; and whether the media's own insider–trading guidelines should be extended to non–editorial employees, such as copy clerks and composing–room workers, who might know about a coming report.

James Michaels, the editor of Forbes, says he once held a story out of an issue when he learned that the subject of an interview had sold stock short in anticipation of a negative article. And in an internal memo about ethics sent to his staff this week, Norman Pearlstine, managing editor of the Wall Street Journal, said that "on several occasions, we've even killed Heard on the Street columns when it's become obvious that word is out on the street as to what we're up to."

But Dan Dorfman, who writes a financial column that appears in 193 newspapers and who also appears on television, says stocks often rise or fall when he starts working on a story about them — and he adds: "It's not my job to police. My job is to get information."

With an increasing number of business publications and financial news shows on television, and with insider–trading laws becoming more muddled, journalists are asking more questions about their own role. Ralph Schulz, senior vice president at McGraw–Hill Inc.'s publications unit, says employees have asked three to four times more questions about the company's trading policies in the past year than ever before.

McGraw–Hill, which publishes Business Week and other financial publications, has a written conflict–of–interest policy based on the premise that "nobody who writes about a company ought to own stock in it," Mr. Schulz says.

Mr. Williams of the Philadelphia Inquirer says that business reporters are assigned specific beats, and are not allowed to own stock in a company within that beat.

The Washington Post requires all business reporters to give a confidential letter to the financial editor outlining their stock holdings, says Jerry Knight, the deputy financial editor. Reporters aren't allowed to write about a company in which they own stock, or buy stock in a company after they have written about it. The New York Times also has a written policy banning such trading; it is handed out about every two years.

The Wall Street Journal has a 3 1/2–page conflict–of–interest policy that prohibits employees from trading stock in

companies that are about to be or were just written about in the newspaper.

"It is not enough to be incorruptible and act with honest motives," the policy says. "It is equally important to use good judgment and conduct one's outside activities so that no one — management, our editors, an SEC investigator with power of subpoena, or a political critic of the company — has any grounds for even raising the suspicion that an employee misused a position with the company."

It was learned yesterday, for example, that the SEC is informally investigating allegations that a stock trader had advance knowledge of certain articles that have appeared in The Wall Street Journal.

The San Jose {Calif.} Mercury–News is distributing its first written ethics code this week, after a year of work. "As a general guideline, staff members shouldn't make news decisions about companies . . . in which they or their spouses have financial interests or hold stock," says the 10–page code.

But written policies against journalists trading on their advance knowledge are the exception.

There have been only two widely known cases in which journalists were caught using information about future articles. One, in 1963, involved the business editor of Time magazine; the other, in 1974, involved a columnist and former financial editor of the Los Angeles Herald–Examiner.

But there have probably been at least a few other cases that have been quietly dealt with — or never discovered. "If it's a problem among lawyers and executives, I imagine it's a problem among journalists as well," said Myron Kandel, financial editor of Cable News Network.

No news executives were concerned about inside trading by non–editorial employees, although many people in a newsroom routinely know about all but the most sensitive investigative reports.

Similarly, the media appear largely unconcerned about trading by subjects of interviews, such as in the Searle case, with some exceptions. Mr. Williams of the Philadelphia Inquirer is generally bothered by the reliance of financial writers on securities analysts. Tim Kelly, managing editor of the Denver Post, says he encourages reporters to examine the motives of their source. Mr. Pearlstine of The Wall Street Journal, in his memo to the staff, said: "Even when it

is obvious through the line of questioning where the story might be leading, we should never characterize the thrust of the piece to anyone."

And James Mitchell, business editor of the San Jose Mercury–News, says the Searle case has given him pause. He currently doesn't stress to reporters that they shouldn't indicate the angle of a story, he says, but "maybe we need to have our consciousness raised."

It is clearly impossible for the media to change their plans every time word leaks out about a future story. And, in any event, investors who bet that a news story will affect the price of a stock are sometimes mistaken: The Arizona scientist, for instance, lost money on his Searle trade.

Most news executives say that uncertainty should help to keep sources from trading on hopes for a future article, because there's not much more the news executives can do. Preventing that kind of insider trading "is an ethical responsibility a newspaper can't assume," in the words of John G. Craig Jr., editor of the Pittsburgh Post–Gazette.

James D. Squires, editor of the Chicago Tribune, agrees — especially, he says, because a newspaper has its hands full just trying to police insider trading by its own reporters. "It's not something you can enforce with a lie detector test," he says, but he adds: "What's funny as hell is you probably can't find 15 newspaper editors in the country who know what a put option is."

GX 55

DOW JONES & COMPANY, INC.
CONFLICTS OF INTEREST POLICY

This policy statement is designed to provide all employees with guidelines which will enable them to avoid conflicts of interest that might be construed to be detrimental to the best interests of Dow Jones. Because of the nature of the Company's business, this statement also applies to the families of each employee (except for item #1).

1. Dow Jones' employees are prohibited, except with written approval of the chief executive officer, from service as directors or officers of any other company devoted to profitmaking. This prohibition, of course, does not apply to employees appointed to serve as directors or officers of companies in which Dow Jones has a significant equity interest. If an employee is involved in a family–owned profitmaking business, clearance should be obtained from the appropriate member of the Management Committee.

2. Employees should not requisition, order, approve or otherwise participate in the purchase of goods or services on behalf of Dow Jones from any company which furnishes material, equipment, supplies or services to Dow Jones if the employee has any significant financial interest in that company, whether by way of stock ownership or loans or otherwise.

3. Employees should not accept, directly or indirectly, any gift, entertainment or reimbursement of expenses of more than nominal value or that exceeds customary courtesies, nor should they accept, payment, loan, services, employment or any other benefit from any company or individual that furnished or seeks to furnish news, material, equipment, supplies or services to Dow Jones.

4. Employees should not offer or provide, directly or indirectly, any gift, entertainment or reimbursement of expenses of more than nominal value or that exceeds customary courtesies, nor should they offer any material, equipment or services to any company or person in a position to make or influence any business or governmental decision affecting Dow Jones.

5. Dow Jones does not contribute directly or indirectly to political campaigns or to political parties or groups seeking to raise money for political campaigns or parties, and Dow Jones does not and will not reimburse any employee for any political contribution made by an employee.

6. Employees should not use, directly or indirectly, for their own or any other person's financial gain, any information about Dow Jones that the employee obtained in connection with Dow Jones employment. Further, employees should not disclose to anyone confidential information obtained in connection with Dow Jones employment until such information has been made available to the public.

7. No Dow Jones fund or asset which is not fully and properly recorded on the books and records shall be created or permitted to exist.

8. No transaction shall be effected and no payment shall be made on behalf of Dow Jones with the intention or understanding that the transaction or payment is other than as described in the documentation evidencing the transaction or supporting the payment.

9. All employees will comply with Dow Jones' accounting principles, procedures and controls and no false, artificial or misleading entries in our books and records shall be made for any reason whatsoever.

10. No Dow Jones employee will:

(a) issue or authorize any official company document that is false or misleading;

(b) knowingly accept and treat as accurate a false or misleading document prepared by a person outside Dow Jones; and

(c) knowingly make false or misleading statements to our external, internal or other auditors.

11. Dow Jones has always had a strict policy on security transactions by employees who have access to inside information regarding unpublished stories or advertising schedules. It also has had a strict related policy on the conduct of news and advertising staff members dealing with corporations we cover or whose advertising we carry. Each employee is expected to bend over backwards to avoid any action, no matter how well–intentioned, that could provide grounds even for suspicion:

(a) that an employee made financial gains by acting on the basis of "inside" information obtained through a position on our staff, before it was available to the general public. Such information includes hold–for–release material, our plans for running stories, items that may

affect price movements, or projected advertising campaigns;

(b) that the writing of a news story or item or scheduling of advertising was influenced by a desire to affect the stock's prices;

(c) that an employee is financially committed to the market so deeply or in such other way as to create a temptation to biased writing or scheduling of advertising;

(d) that an employee is indebted to brokers or any other group we cover, or advertisers. Such indebtedness could arise through acceptance of favors, gifts or payments for performing writing assignments or other services for them;

(e) that an employee is beholden for any tips, allocations of underwritten new issues or in any other way to anyone in the financial community.

While we do not want to penalize our staff members by suggesting that they not buy stocks or make other investments, we reiterate that it is not enough to be incorruptible and act with honest motives. It is equally important to use good judgment and conduct one's outside activities so that no one — management, our editors, an SEC investigator with power of subpoena, or a political critic of the Company — has any grounds for even raising the suspicion that an employee misused a position with the Company.

It is important for all employees to keep in mind the tremendous embarrassment and damage to the Company's reputation that could come about through a lapse in judgment by one person no matter how well–intended that person may be. Because we think it is essential that every employee be above suspicion, we consider any slip in judgment in this area or others covered in this policy statement to be serious enough to warrant dismissal.

With these general propositions in mind, here are some specific guidelines:

(i) First and foremost, all material gleaned by you in the course of your work for Dow Jones is deemed to be strictly the Company's property. This includes not only the fruits of your own and your colleagues' work, but also information on plans for running items and articles on particular companies and industries and

advertising schedules in future issues. Such material must never be disclosed to anyone outside the Company, including friends and relatives. Viewing information as the Company's property should avoid a great many of the obvious pitfalls.

(ii) No employee regularly assigned to a specific industry should invest in any company engaged in whole or significant part in that industry.

(iii) No employee with knowledge of a forthcoming article, item or advertisement concerning a company or industry should, prior to the publication of such article, item or advertisement, invest in that company or companies in that industry; nor, if the employee already owns any such security, should the employee sell it prior to publication without the approval of the appropriate Management Committee member.

(iv) Further, any employee having prior knowledge of a forthcoming article, item or advertisement, should delay trading in the securities of the companies involved until the general public has an opportunity to read and digest the information contained in any Dow Jones publication or news service. Employees should wait two full trading days after an article or advertisement first appears in a Dow Jones publication or news service.

(v) If an employee should inadvertently buy or sell a security or otherwise invest contrary to the guidelines set forth in (iii) or (iv), or if an employee should buy a security prior to publication, and then acquire knowledge of a proposed article, item or advertisement, the employee should notify his or her department head as soon as practical. In the case of a purchase, the employee should hold the security for six months.

(vi) No employee shold engage in short selling of securities.

We believe these guidelines should be easily understood. They aren't intended to deter any employee form participating actively in civic or charitable organizations, provided they have no impact on or connection with Dow Jones. The same applies to political organizations or government advisory boards for the average employee — but news or editorial employees and company executives would be expected to refrain if there was a connection with issues

covered by his or her publication or if his or her superior didn't provide prior clearance.

We urge that whe .ever a situation comes up where a conflict may arise between the interests of Dow Jones and any such civic, charitable, political or governmental organization you refrain form participating in order to avoid any appearance of a conflict of interest. Should any questions ever arise in your mind as to the propriety of your activity, you are urged to consult in confidence with your national department head or any Dow Jones officer.

We would like to emphasize that we have complete confidence in all our employees. It is essential, however, that all of us maintain the highest standards of ethics in the conduct of Dow Jones' business by acting within the framework of these guidelines.

Your cooperation is greatly appreciated.

No. 86-422 (1)

Supreme Court, U.S.
FILED
FEB 28 1987
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and
R. FOSTER WINANS,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Do section 10(b) and Rule 10b–5 impose criminal sanctions on a newspaper columnist for "misappropriating" his newspaper's publication schedule as part of a scheme to trade certain securities, where the newspaper is the only alleged victim of fraud and has no interest in the securities traded?

2. Should this Court reject the expansion of the mail and wire fraud statutes to cover breaches of purely private work-rules, intangible injuries, and incidental mailings and wirings?

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POINT I CRIMINAL SANCTIONS MAY NOT BE IMPOSED ON A NEWSPAPER COLUMNIST, UNDER SECTION 10(b), FOR "MISAPPROPRIATING" HIS NEWSPAPER'S PUBLICATION SCHEDULE AS PART OF A SCHEME TO TRADE CERTAIN SECURITIES, WHERE THE NEWSPAPER IS THE ONLY ALLEGED VICTIM OF FRAUD AND HAS NO INTEREST IN THE SECURITIES TRADED 10

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

NO. 86-422

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion (per Pierce, J., and Mansfield, J.) and dissenting opinion (per Miner, J.) of the United States Court of Appeals for the Second Circuit (Appendix to petition for writ of certiorari, 1a-29a)[1] is reported at 791 F.2d 1024 (2d Cir. 1986). The opinion of the United States District Court for the Southern District of New York (33a-73a) is reported as *United States v. Winans*, 612 F. Supp. 827 (S.D.N.Y. 1985) (Stewart, J.).

JURISDICTION

The judgment of the Second Circuit was entered on May 27, 1986. Petitions for rehearing with suggestions for rehearing *en banc* were denied on July 17, 1986 (30a-32a). The petition for writ of certiorari was filed on September 15, 1986 and was granted on December 15, 1986. 107 S. Ct. 666

1. Citations to the appendix to the petition for writ of certiorari are denoted by the lower-case "a" following the page number ("___a"). Citations to the Joint Appendix are denoted as "App.___"; citations to the trial transcript in the district court as "T.___"; and citations to government and defense trial exhibits as "GX___" and "Exh.___", respectively.

(1986). The jurisdiction of the Court rests on 28 U.S.C. § 1254(1) (1982).

STATUTES INVOLVED

Petitioners were convicted of violating section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5 (1986), and the mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343 (1982). Petitioners Felis and Winans were convicted of conspiring to violate the aforesaid statutes. 18 U.S.C. § 371 (1982). These provisions are set out verbatim on pages 2–4 of the petition for certiorari.

STATEMENT OF THE CASE

a. "Heard on the Street"

From August 1982 through March 1984, petitioner R. Foster Winans, a reporter for The Wall Street Journal (the "Journal"), was one of the writers of "Heard on the Street," a daily market gossip column which focused on the movements and prospects of various stocks. The Heard column did not purport to give investment advice, and the Journal did not view or present the column as giving such advice to readers.[2] The Journal's wide readership and the column's popularity, however, tended to give the column a short-term impact upon the market price of stocks it mentioned. 612 F. Supp. at 830; 35a-36a.

Winans chose stocks to mention in the column on the basis of unusual trading volume, significant price moves, recent Securities and Exchange Commission ("SEC" or "Commission") filings, and company announcements. He conducted interviews for the column with Wall Street sources who offered analyses of significant stock movements and predictions of future price direction. These sources — as well as their customers, friends and relatives — were free to trade at any time upon the information they gave Winans or the prospect of its publication in the Journal. Occasionally, they did so (T. 401, 1881).

Winans' columns never contained corporate "inside" information or "hold-for-release" information given to the Journal for dissemination at a specified time. 612 F. Supp. at 830 n.2; 35a n.2. As the district court expressly found, "Winans was not a temporary insider [of the corporations he wrote about], did not owe any duty to the corporations he wrote about, and was not a tippee of any corporate inside information. . . . [N]either Winans nor the Wall Street Journal owed any duties

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2. The Journal, a newspaper of general circulation, does not fall within the coverage of the Investment Advisors Act of 1940. *See* 15 U.S.C. § 80b-2(a)(11)(D) (1982). Even prior to this Court's opinion in *Lowe v. SEC*, 472 U.S. 181 (1985), which substantially limited the class of investment advisors, neither the SEC nor any other regulatory agency had ever suggested the contrary (T. 50, 396-97).

at all to the corporations that were the subject of Heard columns or to the shareholders of those corporations." 612 F. Supp. at 841; 56a.

b. Winans' Trading Arrangement

In mid–October 1983, Winans agreed to tell stockbroker Peter Brant the subject matter (name of stock), general tenor (positive or negative), and probable publication date of forthcoming Heard columns (T. 2078–79). According to the district court's findings of fact, Winans and Brant agreed that "the arrangement would not affect the journalistic purity of Winans' writing . . . [or] influence his choice of topic or the contents of any article; he would continue to write balanced pieces, containing both positive and negative information." 612 F. Supp. at 832; 40a. The trading decisions were left totally to Brant, who was told that any scheduled column might unexpectedly be cancelled. Net profits were to be split after Brant deducted fifty percent for taxes, and Winans would receive nothing if there were no profits. *Id.*; T. 2079–80.

Over the next four and one–half months, Brant bought and sold securities upon information supplied by Winans. Brant made all trading decisions, such as when to buy or sell securities, what types to trade (common stock or options, and which particular option series), and the amount of each transaction (T. 617, 2477). In executing the trades, Brant enlisted the assistance of a fellow stockbroker, petitioner Kenneth P. Felis, in whose accounts many of the trades were made.

Winans obtained the information furnished to Brant in the normal and lawful course of his employment. He did not engage in any thefts, break–ins, rifling of files, decoding of secrets or unauthorized entries into computer files (T. 2158–59, 2168, 2211). Though Winans believed that discovery of his arrangement with Brant would result in his dismissal (T. 2228; GX 343, at 253–54), neither Winans, Brant, nor Felis believed that they were acting illegally (T. 926, 955, 1295, 1889).[3]

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3. Brant, who was the government's chief witness at trial, pleaded guilty to a separate information charging conspiracy and securities fraud. At the government's insistence, Brant's plea agreement contained an express provision that he must re–plead to other offenses if this Court disapproves the

During the four and one–half months that the trading arrangement lasted, Winans continued to write his articles conscientiously and accurately.[4] As anticipated, columns about which Winans had told Brant were occasionally delayed (T. 2108, 2206–07, 2279–80, 2304, 2308). Stock prices generally — but not always — moved in a direction consistent with the column's positive or negative tenor. Of the twenty–four transactions alleged in the securities fraud counts,[5] profits were made in twenty and losses were sustained in four (Exhs. W–E, W–F; App. 22, 23).

During this same period, unbeknownst to Brant and Felis, Winans also made six small pre–publication trades through an account opened in the name of petitioner David Carpenter, Winans' roommate. These trades resulted in total profits of $4,502.84 (Exh. W–D; App. 21).[6]

c. The Dow Jones "Conflicts of Interest Policy"

Winans' arrangement with Brant and Felis, as well as his separate trades in the Carpenter account, violated the private policy guidelines of the Journal's owner, Dow Jones & Co., Inc. ("Dow Jones"). Specifically, the written "Conflicts of Interest Policy" (GX 55; App.39) provided, along with much else, that knowledge of forthcoming Journal articles was "deemed" the "property" of Dow Jones, that an employee could not disclose

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government's securities fraud theory (Exh. F–C).

4. Copies of the Journal articles which formed the basis for the substantive counts of petitioners' indictment (GXs 9–27, 29–36) will be lodged with the Court prior to argument.

5. The indictment upon which petitioners were tried contained 61 counts, consisting of a conspiracy count (Count 1), 24 securities fraud counts (Counts 2–25), 18 wire fraud counts (Counts 26–43) and 18 mail fraud counts (Counts 44–61). All of the mail and wire fraud counts, and most of the securities fraud counts, involved articles written by Winans. Seven of the 24 securities fraud counts (Counts 6, 7, 12, 14, 16, 17 and 21) involved articles written by others at the Journal about which Winans learned in the ordinary course of his work. The indictment is set forth at App. 1 – 20.

6. Six securities fraud counts (Counts 14, 17, 18, 21, 22 and 24) and six mail and wire fraud counts (Counts 38, 41, 42, 56, 59 and 60) were based on these trades. These were the only twelve counts on which petitioner Carpenter was found guilty (as an aider and abettor). Carpenter was acquitted of the conspiracy count.

the subjects or schedules of forthcoming articles to persons outside the newspaper,[7] and that an employee could not buy or sell stocks if he was writing an article about the stock or knew such an article was to appear in the newspaper.[8]

These rules, contained in the back of a 44–page pamphlet distributed to Journal employees (GX 54),[9] were promulgated unilaterally by Dow Jones. They were not part of the agreement governing Winans' employment that was negotiated between Dow Jones and Winans' union (Exhs. WU–1, WU–2; T. 121).

Dow Jones, which has been in existence for over 100 years, had no such rules for its employees until the 1960's and never informed the public of its rules until after the events of this case (T. 115–16, 159). The Journal first informed its readers of the policy in a March 2, 1984 article entitled *Media Policies Vary on Preventing Employees and Others From Profiting On Knowledge of Future Business Stories*, which reported that most newspapers and broadcasters had no such policy (Exh. WSJ–9; App. 35).

At trial, the government expressly conceded that in the absence of Dow Jones' rules, petitioners' conduct would not have violated the securities laws (*see* Gov't Reply Memorandum of Law in Response to Defendants' Pretrial Memoranda, at 21; 612 F. Supp. at 842; 58a). Yet these rules, though warning that violations could result in termination of employment (GX 55; App. 43), were themselves expressly presented to Dow Jones' employees as intended to go well beyond the requirements of the law. They were explicitly designed to avoid even a "misperception" of impropriety, described by Journal officials as

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7. This rule was referred to in the opinions below as a "confidentiality policy."

8. Dow Jones' 3–1/2 page, single–spaced written policy is set forth verbatim in the Joint Appendix (GX 55; App. 39). Under the policy, Winans was permitted to buy a stock even for the short term, or to sell a stock he already owned, provided he did not write an article about the stock and knew of no such forthcoming article by someone else at Dow Jones. Otherwise, he was required to wait two full trading days after the article first appeared before trading in the stock (GX 55; App. 41–42).

9. GX 54 will be lodged with the Court prior to argument.

intended to make employees "squeaky clean," "above suspicion," and "as pure as Caesar's wife" (T. 135–36, 231, 319, 1523), and written in terms of "bending over backwards" to avoid even a "suspicion" of impropriety (GX 55; App. 40).[10]

d. The Aftermath of Winans' Conduct

When Winans' trading arrangement became known to the Journal, he was immediately fired. Dow Jones suffered no actual damage from Winans' conduct. The Journal broke the story of Winans' arrangement with Brant on March 29, 1984 (T. 106; GXs 38, 39). Yet its earnings, total revenues and advertising revenues for the second quarter of 1984 (ending June 30, 1984) all rose to record levels (T. 107, 252–57; Exh. W–A). *Fortune Magazine*'s January 7, 1985 issue rated Dow Jones as the most admired corporation in America for quality of products and services, as second only to IBM for quality of management and for long–term investment value, and as the number one publishing company in America (T. 107–10; Exh. W–K).

An SEC injunctive action filed on May 17, 1984 (*SEC v. Brant*, 84 Civ. 3470 (S.D.N.Y.)) was settled against petitioners with the entry of consent decrees and petitioners' disgorgement of all of their trading profits.[11] 17 Sec. Reg. & L. Rep. (BNA) No. 42, at 1884 (October 25, 1985) (Winans and Carpenter); 17 Sec. Reg. & L. Rep. (BNA) No. 32, at 1445 (August 9, 1985) (Felis).

e. Proceedings below

The indictment charged that the sole victim was Dow Jones and not any securities investor or reader of the Journal.[12]

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10. The Dow Jones internal policy has always been described to employees as going beyond the requirements of the law, rather than as a statement of the law. For example, the 1973 version of the written policy (Exh. W–M; App. 24), after quoting from the Second Circuit's decision in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (*en banc*), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969), immediately went on to state "[b]ut we want to do more than just satisfy the regulations."

11. Felis disgorged a total of $159,813.93, representing his pre–tax profits in the trading scheme. Winans disgorged the $4,502.84 pre–tax profit from the trades in the Carpenter account.

12. The original indictment also contained a so–called "readership"

After a non-jury trial, the district court found that petitioners' conduct constituted securities, wire and mail fraud.[13] Rejecting petitioners' arguments that Winans' conduct did not constitute fraud upon Dow Jones and that the "misappropriation theory" should be limited to misappropriation from market participants, the Second Circuit affirmed the convictions (with certain minor exceptions),[14] over a vigorous dissent by Judge Miner as to the securities fraud counts.

Winans and Felis — the two petitioners who were sentenced to terms of imprisonment — remain at liberty pending the decision of this Court.[15]

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theory in which the readers of the Journal were alleged to have been defrauded. The government dropped the "readership" theory and proceeded to trial on a superseding indictment which alleged fraud against the Journal only.

13. In addition to the conspiracy count with which all defendants were charged, Winans was charged with 60, Felis with 40, and Carpenter with 12 substantive counts. Two of the securities fraud counts against Winans and Felis (Counts 19 and 25) were dropped by the government at the close of its case. Aside from an acquittal of Carpenter on the conspiracy count, the three defendants were convicted of all remaining counts with which they were charged.

14. Winans' securities fraud convictions on Counts 15, 20, and 23 were reversed. These involved securities transactions by Felis' friend, Stephen Spratt, of which Winans had no knowledge and which were beyond the scope of his agreement with Brant and Felis. 791 F.2d at 1036; 26a.

15. Winans was sentenced to 18 months' imprisonment to be followed by five years of probation, during which he is to contribute 400 hours of community service. Winans was also fined $5,000.00. Felis was sentenced to six months' imprisonment to be served on weekends, to be followed by five years of probation and 500 hours of community service, and was fined $25,000.00. Carpenter was sentenced to three years of probation with 200 hours of community service, and was fined $1,000.00.

SUMMARY OF ARGUMENT

1. Petitioners did not commit securities fraud

Statutory language, legislative history, precedents of the Court, and public policy do not permit the imposition of criminal sanctions against petitioners under section 10(b) and Rule 10b–5. The "misappropriation theory" cannot be used to punish conduct which does not involve manipulation of securities prices, deception of investors, use of "inside information," breach of duty to a market participant, or injury to a market participant. Breach of an employer's private workrules is not fraud, let alone securities fraud. Because the "misappropriation theory" is wholly undefined, and because its expansion by the courts below could not reasonably have been anticipated, the criminal prosecution of petitioners violated fundamental tenets of due process.

2. Petitioners did not commit mail or wire fraud

Petitioners'conduct was not mail or wire fraud because (a) there was no actual deception by petitioner Winans, but only a breach of his employer's workrules; (b) an unrealized potential for intangible injury to the Journal's reputation cannot satisfy the harm requirement of the statutes; and (c) the mailings and wirings underlying the convictions were not caused by petitioners, were not made for the purpose of executing the alleged scheme, and would have had the identical form and content in the absence of any scheme. The courts below erroneously substituted a judicially–created doctrine of fiduciary duty for the statutory requirement of fraud, erroneously permitted potential harm to intangibles such as reputation to satisfy the requirement of threatened economic harm, and erroneously allowed incidental mailings and wirings to satisfy the statutory requirement of mailings and wirings caused for the purpose of executing a fraudulent scheme. This expansion and distortion of the statutes improperly uses federal criminal sanctions to regulate private employment relationships. Such regulation should be left to the states.

ARGUMENT

POINT I

CRIMINAL SANCTIONS MAY NOT BE IMPOSED ON A NEWSPAPER COLUMNIST, UNDER SECTION 10(b), FOR "MISAPPROPRIATING" HIS NEWSPAPER'S PUBLICATION SCHEDULE AS PART OF A SCHEME TO TRADE CERTAIN SECURITIES, WHERE THE NEWSPAPER IS THE ONLY ALLEGED VICTIM OF FRAUD AND HAS NO INTEREST IN THE SECURITIES TRADED

Although convicted of securities fraud, petitioners were not insiders, temporary insiders or tippees. They did not manipulate the price of any security. They owed no duty — direct or indirect — to the shareholders of any company whose securities they traded. They did not trade upon any secrets of the companies whose securities they bought and sold. The only victim of fraud alleged by the government and found by the district court was the Journal, a financial newspaper which had absolutely no interest in the purchase, sale or value of any of the securities traded by petitioners. The sole basis for petitioners'securities fraud convictions was the violation of the Journal's internal workrules by petitioner Winans, who was then employed as a Journal columnist. The only alleged harm from the "securities fraud" was the potential injury to the Journal's reputation.

Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") "never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper." 791 F.2d at 1037; 29a (Miner, J., dissenting). Nevertheless, that is the singular result of the judgment below.

We show in Point II that Winans'breach of the Journal's workrules did not constitute a criminal fraud at all. In this section, we focus on the narrower question of whether an alleged fraud against a person who neither participates in, nor has any interest in, the purchase, sale or value of securities, can constitute a criminal violation of section 10(b). We submit that it cannot. To apply section 10(b) where there is no securities-related duty or injury, but only a breach of an employer's

private workrules, perverts the purpose of the federal securities regulatory scheme, undercuts the predictability of law, provides no extra protection to investors, and leads to a host of inconsistent and irrational results which are neither supported by the language and legislative history of section 10(b) nor justified by public policy.

A review of what is *not* in dispute in this case shows how far afield the government has gone. First, the government did not claim that Winans' articles were altered, slanted, or falsified in any way in order to affect or manipulate the price of any security.[16] Nor were Winans' articles "planted" for the purpose of "touting" or "publicizing" any security.[17] The courts below specifically found that the subject matter and tenor of all articles on which the fraud counts were based had been chosen before petitioners decided to trade the securities mentioned in the articles; that the articles were not intended to influence the price of any security; and that the accuracy and quality of Winans' work were not affected by his trading arrangement. 791 F.2d at 1027; 7a; 612 F. Supp. at 834–35; 44a.

Second, the government did not allege, and the lower courts did not find, that the informational content of Winans' articles was "non–public." Nor was Winans, by virtue of some relationship of trust or confidence with the corporations about which he wrote, barred from trading in their securities. Winans' sources were not corporate "insiders." 612 F. Supp. at 841; 56a. The facts contained in Winans' articles were publicly available.

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16. Affirmatively false statements or half–truths deliberately made to inflate or depress the price of a security would be a "manipulative or deceptive device or contrivance" under section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) (1982), and Rule 10b–5 promulgated thereunder by the Commission, 17 C.F.R. § 240.10b–5 (1986).

17. Section 17(b) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(b) (1982), prohibits accepting payment or other consideration in return for publicizing any security in a newspaper, unless such consideration is disclosed, irrespective of the truth or falsity of the article. Had Winans taken money to tout particular stocks, geared the content of his columns to his trading arrangement, or intended to influence the price of any security through his articles, that conduct would have violated section 17(b) of the Securities Act, section 10(b) of the Exchange Act, or both.

Knowledge of those facts, and anticipation of Winans'articles, provided a lawful basis for trading by Winans' sources (generally brokers, investors and securities analysts) and his sources' customers. *See, e.g.*, GX 23, Exhs. DJT–14, Q–1, Q–2.[18] Only the fact and date of publication and the general positive or negative tenor of the articles were "non–public." Had the Journal decided not to print an article submitted by Winans, he would have been free to trade upon the information he obtained about the company. Similarly, had Winans decided not to write an article after researching a company, he would have been free to buy or sell its securities.

Third, the government did not allege that any member of the investing public was defrauded or injured in any way. It is not claimed that any seller of securities received too little or any buyer of securities paid too much as a result of petitioners'trades; nor were petitioners charged with artificially affecting the market prices of the stocks involved.

Petitioners' securities fraud convictions turned wholly upon the existence of a particular Dow Jones internal policy which had never been revealed to Journal readers or the investing public, which did not exist at most-other newspapers, which was presented to employees as going beyond the requirements of the law, and which Dow Jones itself was free to ignore. If the Journal had no policy or had a different policy,[19] if Winans had worked for one of the many newspapers without comparable workrules, or if Winans had been a "free–lancer" to whom the Journal policy did not apply, there would have been no violation of the securities laws.[20] Never has this Court permitted purely private rules to serve as the basis for criminal prosecution of otherwise lawful conduct. Never before have the federal securities laws been used to enforce an employer's internal

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18. The government never disputed that Winans' sources were free to trade upon that information — and often did — legally and properly.

19. For example, a newspaper might simply require its reporters to provide periodic lists of their securities transactions.

20. As noted, the government conceded below that "without any [Dow Jones] policy, there could be no prosecution under the misappropriation theory." 612 F. Supp. at 842; 58a.

policy where the employer had no interest – – direct or indirect – – in any of the securities involved. Because the Journal's interest in its confidential publication schedule is not within the zone of protection which Congress intended to create when it enacted the antifraud provision of the Exchange Act, petitioners' convictions should be reversed.

A. Under Section 10(b), Criminal Fraud Cannot Be Premised Upon The Breach of a Private Policy Where There is No Manipulation of Securities Prices or Deception of Market Participants

"The starting point in every case involving construction of a statute is the language [of the statute] itself." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)). Section 10(b) prohibits the use "in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . in the public interest or for the protection of investors." Hence, Winans' breach of Dow Jones' internal corporate policy is violative of section 10(b) only if it constituted a "manipulative or deceptive device or contrivance" cognizable under that statute.

The legislative history of section 10(b) establishes that the statute's proscription of manipulative or deceptive devices or contrivances was enacted to protect public investors and not to protect the reputation of a financial newspaper or to enforce an employer's internal guidelines regulating employee conduct.[21]

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21. The Senate Report accompanying the Securities Act states that:

> The purpose of this bill is to protect the investing public and honest business . . . The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation. . . .

S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933). The Exchange Act was enacted a year after the Securities Act as another "step in our broad purpose of protecting investors and depositors." H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933) (Letter, dated March 29, 1933, from President Roosevelt to Congress). The Exchange Act was aimed primarily at uncontrolled and exces-

Fifty years of jurisprudence since the enactment of section 10(b) further confirm that a "manipulative or deceptive device or contrivance" cognizable under the Exchange Act is one that artificially affects the price of securities or otherwise deceives investors or persons engaged in the process of buying or selling stock.[22] As stated by this Court, "a violation [of section 10(b)] may be found *only* where there is 'intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.'" *Dirks v. SEC*, 463 U.S. 646, 663 n.23 (1983) (quoting *Hochfelder*, 425 U.S. at 199) (emphasis added). Consistent with the legislative purpose and language of the statute, this Court has never held section 10(b) applicable where the victim had no stake or role whatever in the underlying securities transaction.

To support the application of section 10(b) to Winans' breach of Dow Jones' private policy, the government and the courts below relied upon *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). In that case,

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sive speculation in the purchase and sale of securities and the manipulation of prices harmful to public investors. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 2–3 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 3 (1934).

22. "Manipulation" is "virtually a term of art when used in connection with securities markets." *Hochfelder*, 425 U.S. at 199. As the legislative history of the Exchange Act makes clear, the term "manipulation" refers to various practices directed at investors. H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934). This Court, recognizing the legislative intent underlying section 10(b), has declared that "[t]he term [manipulation] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are *intended to mislead investors* by artificially affecting market activity." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476 (1977) (emphasis added). *See Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 6–8 (1985). In *Santa Fe Industries, Inc.*, this Court stated further that:

> Section 10(b)'s general prohibition of practices deemed by the SEC to be "manipulative" — in this technical sense of artificially affecting market activity in order to mislead investors — is fully consistent with the fundamental purpose of the 1934 Act "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* . . . ."

430 U.S. at 476–77 (quoting *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972)).

the fraud involved the diversion of the proceeds of a sale of securities from the corporation that owned the securities. Rejecting defendants'argument that Rule 10b–5 did not apply because the sale itself was free of fraud, this Court held that the diversion of the proceeds caused the corporation "an injury as a result of deceptive practices" sufficiently "touching its sale of securities as an investor" to come within the protective zone of section 10(b). *Id.* at 12–13.

It is one thing to say that a deceptive device which deprives an investor "of any compensation for the sale of its valuable block of securities," *id.* at 10, sufficiently touches the investor's interest in the transaction to be within the scope of the securities laws; it is quite another to state that a fraud upon a person who is not a market participant violates section 10(b) so long as it is otherwise related in *any* manner — however remote or tangential — to the purchase or sale of a security. As then Circuit Judge Stevens recognized in *Eason v. General Motors Acceptance Corp.*:

> The emphasis on the injured party's status as an investor indicates that the protection of the rule extends to persons who, in their capacity as investors, suffer significant injury as a direct consequence of fraud in connection with a securities transaction, even though their participation in the transaction did not involve either the purchase or the sale of a security.[23]

In reaching this conclusion, Judge Stevens noted the Commission's own declaration that injury must be suffered in the victim's "capacity as an investor." *Id.* at 659 & n.23 (quoting Brief for the Securities and Exchange Commission, at 23).[24]

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23. 490 F.2d 654, 659 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

24. *United States v. Naftalin*, 441 U.S. 768 (1979), relied upon by the government below, is not to the contrary. In *Naftalin*, the victims injured directly by a fraudulent securities transaction were not investors but brokers who executed a short sale. Interpreting section 17(a) of the Securities Act, which covers "offers" to purchase or sell securities, this Court said the anti-

Accordingly, in determining what conduct violates section 10(b), courts have inquired not simply whether fraud by non–disclosure has occurred, but whether the undisclosed statement was "material" to the investment decision;[25] not simply whether there has been a deception, but whether the deception directly affected an investment decision;[26] not simply whether a misrepresentation has been made, but whether the misrepresentation pertained to the value either of the security or of the assets for which the security was purchased or sold.[27] Each of

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fraud provision is "expansive enough to encompass the entire selling process, including the seller/agent transaction." *Id.* at 773.

25. The requirement of "materiality," which has uniformly been defined in terms of a decision to participate in the purchase or sale process, makes little sense if the victim of the fraud need not have any interest whatsoever in the underlying securities transaction. Because the Journal was not contemplating any securities transaction, Winans' non–disclosure of his breach of the private workrules could not possibly be "material" as that term is defined in the case law. *See SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860 (2d Cir. 1968) (*en banc*) (deceit must be "of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities"), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969).

26. Section 10(b) does not require the disclosure of material information by an employee to an employer (such as Dow Jones) *not* involved in an investment decision, even where the required disclosure would justify termination of the employment arrangement. *O'Brien v. Continental Illinois National Bank and Trust Co.*, 593 F.2d 54, 60 (7th Cir. 1979). *See also Congregation of the Passion, Holy Cross Province v. Kidder Peabody & Co.*, 800 F.2d 177, 181–82 (7th Cir. 1986) (nondisclosure by investment manager employed by religious community not within protection of Rule 10b–5); *Harris Trust and Savings Bank v. Ellis*, 609 F. Supp. 1118, 1120–21 (N.D. Ill. 1985) (transactions justifying termination of trustees for nondisclosure of conflicts of interest did not violate federal securities laws); *Hackford v. First Security Bank of Utah*, 521 F. Supp. 541, 552 (D. Utah 1981) (trustee's failure to disclose to beneficiaries information regarding investments not actionable under Rule 10b–5), *aff'd*, [1983–1984] Fed. Sec. L. Rep. (CCH) ¶ 99,402 (10th Cir.), *cert. denied*, 464 U.S. 827 (1983); *Blackmar v. Lichtenstein*, 438 F. Supp. 803, 807 (E.D. Mo. 1977) (nondisclosed self–dealing by trustee adverse to beneficiaries' interest does not constitute securities fraud), *rev'd on other grounds*, 578 F.2d 1273 (8th Cir. 1978).

27. *Eason*, 490 F.2d at 656 (Stevens, J.) (misstatements and material omissions may relate to value of assets acquired rather than value of security delivered and, nonetheless, have been made "in connection with" the sale of a

these inquiries is wholly irrelevant, however, if the purported "victim," such as Dow Jones in this case, has no interest or involvement in the purchase or sale of securities.

The prosecution here proceeded under the "fraud" language of Rule 10b–5, which is subject to the general limitations of section 10(b).[28] Trading securities on the basis of undisclosed information is fraud under section 10(b) and Rule 10b–5 only where the trader owes a duty of disclosure to a market participant. As stated by the principal draftsman of Rule 10b–5, the occasion for the adoption of the rule was an instance of a corporate insider trading unfairly on the basis of inside information. The rule was adopted because of a report that "the president of some company . . . is . . . buying up the stock from his own shareholders at $4.00 per share, and that he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be $2.00 a share for the coming year." Freeman, *The Insider Trading Sanctions Bill — A Neglected Opportunity*, 4 Pace L. Rev. 221, 222 (1984) (quoting Freeman, *Administrative Procedures*, 22 Bus. Law. 891, 922 (1967)).[29] That situation involved not only direct misrepresentations to investors but a violation of a fiduciary obligation of the president to the shareholders in his own corporation, conduct plainly amounting to common law fraud.

The requirement of a duty to a market participant in insider trading cases was formulated by the Commission itself in *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). In that case, the Commission held that a broker/dealer and his firm had violated section 10(b) by selling securities on the basis of undisclosed information obtained from a corporate insider of the issuer, because "insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known,

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security).

28. *Hochfelder*, 425 U.S. at 212–14.

29. *See also Hochfelder*, 425 U.S. at 213 n.32 (Marshall, J.); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 767 (1975) (Blackmun, J., dissenting).

would affect their investment judgment." *Id.* at 911. The Commission said its task in determining whether there was fraud was "to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities." *Id.* at 912.

Later, this Court in *Chiarella v. United States*, 445 U.S. 222 (1980), held that silence accompanied by trading cannot constitute a fraudulent non-disclosure under section 10(b) and Rule 10b-5 unless there exists "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." *Id.* at 230. This Court squarely rejected the notion that, in the absence of such a duty, an obligation to disclose material information to the investing public arises from mere possession of superior knowledge. *Id.* at 232-35. It made no difference that Chiarella's knowledge resulted from special access to information not legally accessible either to the shareholders of the corporation whose securities were traded or to the public at large. *Id.* at 235 n.20.

In *Dirks*, this Court emphasized that the obligation to "disclose or refrain" under Rule 10b-5 requires the existence of a specific relationship — direct or derivative[30] — between the company whose stock is traded and the individual who trades on material non-public information. 463 U.S. at 654-55.[31] Accordingly, the district court concluded that to "find *Dirks* controlling would be to find no securities violation" by petitioners. 612 F. Supp. at 841; 56a.

Dirks and *Chiarella* require reversal of petitioners' convictions under Rule 10b-5, unless this Court not

30. In *Dirks*, the Court noted that outsiders such as underwriters, accountants, lawyers or corporate consultants become temporary insiders because of their confidential relationship to the corporation and access to inside information. 463 U.S. at 655 n.14.

31. *Dirks* also held that a tippee inherits the insider's obligation to disclose or refrain from trading only where the tippee knows the tip was given in violation of the insider's fiduciary duty to the corporation. Only then does the tippee become an "accessory after the fact" to the insider's breach. 463 U.S. at 660.

only adopts the "misappropriation theory" on which it reserved decision in *Chiarella*, but extends that theory to facts — beyond anything contemplated in any previous case — involving neither a duty to a market participant nor a victim who is a market participant. Such an extension would be inconsistent with the history and purpose of section 10(b) and Rule 10b–5 and should not be effected absent a specific Congressional mandate.

B. Absent Any Duty or Injury To a Market Participant, "Misappropriation" Cannot Be a Violation of Section 10(b)

In the "insider trading" context, a "misappropriation theory" might arguably be applied without doing violence to the historic meaning of fraud[32] or to the intent of the federal securities laws where "misappropriated information" belongs to a market participant.[33] Such a theory makes best sense where the "misappropriated information" belongs to the corporation whose stock is traded. In these circumstances, the "misappropriation theory" comports with the limiting principles of *Dirks* and *Chiarella*. Like the tippee discussed in *Dirks*, one who misappropriates a corporation's information "inherits" the corporation's duty to its shareholders.

In the tender offer context, a "misappropriation theory" likewise makes best sense where an insider or temporary insider of, or misappropriator from, the *target* company buys *target* company stock with knowledge of a planned but yet unannounced takeover. The "misappropriation theory" would still apply, albeit more tenuously, where the purchaser of *target* company stock is an insider or temporary insider of, or misappropriator from, the *acquiring* company. Here, the

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32. Illustrative is the English case of *Phillips v. Homfray*, L. R. 6 Ch. 770, 779–80 (1871), where defendants first trespassed upon property, discovered and converted coal, and subsequently contracted to purchase the property from the owner without disclosure of the discovery.

33. *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983); *SEC v. Musella*, 578 F. Supp. 425 (S.D. N.Y. 1984).

valuable non–public information emanates from the *acquiring* company rather than the target company whose shares are purchased. Because application of the theory in this instance is tenuous, the Commission in 1980 promulgated Rule 14e–3, which prohibits any person who possesses material non–public information relating to a tender offer, and which was acquired directly or indirectly from either the offeror or the target, from trading on the securities of either the offeror or the target.[34] 17 C.F.R. § 240.14e–3 (1986).

In this case, however, neither traditional duty analysis nor a "misappropriation theory" is applicable. The information used by Winans did not belong to the corporations whose securities he traded. Winans had no relationship — direct or derivative — with those companies. As Judge Miner, dissenting below, observed:

> No confidential securities information imparted by reason of any special relationship was purloined by these defendants. The "Heard" columns written by Winans consisted of high quality, accurate articles dealing with the strengths and weaknesses of various securities, and the research data upon which the columns were based were fully available to the public. To say that the 'publication schedule' of the Wall Street Journal was the non–public, confidential information stolen by the defendants is to extend the sweep of section 10(b)

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34. Before Rule 14e–3, the Commission sought to proscribe the same conduct under Rule 10b–5. The Commission argued that purchases of the target corporation's securities based on knowledge of the acquiring corporation's secret plans would artificially inflate the price of the target's securities, thus jeopardizing the success of the tender offer. It was precisely on this basis that the Commission argued in *Chiarella* that the *acquiring* corporation, itself a market participant, had been defrauded. It was these issues — whether a duty to the *acquiring* corporation exists, whether it was breached, and whether such a breach constitutes a violation of section 10(b) — which this court left open in *Chiarella*. 445 U.S. at 236–37; *id.* at 238 (Stevens, J., concurring). Even if these issues (now mooted by Rule 14e–3) were to be answered affirmatively, they would not govern the situation here because Dow Jones is not a market participant.

and rule 10b–5 beyond all reasonable bounds. Knowledge of publication dates simply is not the special securities–related knowledge [properly] implicated in the misappropriation theory.[35]

Nor was any duty owed to or injury inflicted upon any market participant.[36] By eliminating the need for a connection between "misappropriation" and a market duty or injury, the Second Circuit majority has transformed Rule 10b–5 into a law governing relationships outside the securities markets, in this case the relationship between a newspaper and its employee. Here, the duty breached involves no more than contractual, quasi–contractual, or so–called "fiduciary" obligations of an employee to his employer.[37] The opinion below thus represents a dramatic departure from past precedent, and, if affirmed, will require the development of a body of federal "fiduciary" law to be applied in any situation where securities are even tangentially involved.[38]

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35. 791 F.2d at 1037; 28a–29a (Miner, J., dissenting).

36. The "misappropriation theory," as previously applied by the Second Circuit in *Newman* and *Materia* (and as previously hypothesized in *Chiarella*), involved breaches of the fiduciary duties, owed by investment banks, financial printers and others similarly situated, and their respective employees, not to misappropriate confidential *client* information concerning proposed securities transactions such as tender offers. The victims of the misappropriations in *Newman* and *Materia* were market participants — corporations planning to engage in securities transactions in connection with contemplated tender offers.

37. As noted at page 32, *infra*, it is far from clear that all obligations of an employee to an employer are fiduciary in nature.

38. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), this Court held that even breaches of duty directly affecting transactions in securities registered under the Exchange Act do not constitute violations of section 10(b) and Rule 10b–5 when neither manipulation of stock prices nor deception of investors is involved. The Court reasoned that to apply Rule 10b–5 in such a situation "would be to bring within the Rule a wide variety of corporate conduct traditionally left to state regulation," and that "the extension of the federal securities laws would overlap and quite possibly interfere with state corporate law." *Id.* at 478–79. This Court, "reluctant to federalize" state corporation law, refused to extend the scope of section 10(b) and Rule 10b–5 to cover breaches of duty traditionally governed by state law "absent a clear indication

C. The Extension of the "Misappropriation Theory" Below Leads to Irrational Results

The form of "misappropriation theory" applied by the courts below leads to the bizarre result that Dow Jones could have lawfully entered the trading arrangement with Brant, but Winans could not. It leads to the further bizarre result that a reporter for a newspaper without a policy such as the Dow Jones policy could have lawfully done exactly what Winans did. Yet, in both cases, the effect of the "lawful" and "unlawful" conduct on market participants is the same. Section 10(b), with its focus on protection of investors and the public, cannot logically permit such distinctions. The analysis adopted below causes an irrational incidence of criminal liability based on a happenstance unrelated to any interest of the investing public.

The facts of the *Dirks* case further demonstrate the incongruity of the government's expanded "misappropriation theory." Raymond Dirks had been told by Ronald Secrist, a former officer of Equity Funding, that Equity Funding's assets were fraudulently overstated. Dirks informed Wall Street Journal correspondent William Blundell of the fraud, but Blundell at first declined to write an article. Meanwhile, Dirks told his investor clients, and they sold $16 million of Equity Funding stock. Blundell then wrote the article.

This Court held that Dirks' conduct was lawful because Dirks had no duty arising from any special relationship with Equity Funding and because his source, Secrist, had not breached his fiduciary duty to Equity Funding in revealing the fraud to Dirks. But under the misappropriation theory adopted below, the reporter, Blundell, would be guilty of a federal crime if he had traded shares of Equity Funding before his story was published. Blundell would be subject to criminal prosecution for securities fraud, even though (as noted) his employer, Dow

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of congressional intent" to do so. *Id.* at 479. Here, the "duty" underlying this prosecution arises solely out of the employment relationship, which has long been governed by the common law and, in certain instances, state legislation. There is no federal common law governing employer–employee relationships, and there is no principled reason to rewrite section 10(b) to redress breaches of Winans'duty to his employer.

Jones, would itself be under no similar disability,[39] and even though (as *Dirks* holds) Secrist, Dirks and Dirks' clients had not violated the law.[40]

A still further anomaly arising from the "misappropriation theory" adopted below is that it permits the government to misuse a private company rule to resurrect — at the pain of criminal penalties — the "parity of information" and "equal access to information" theories that were explicitly rejected by this Court in *Chiarella*. 445 U.S. at 235 n.20. If an employer as a matter of policy declares that its employees should obey the "parity of information" rule even in situations where neither the employee nor employer have any independent duty of confidentiality to a company or its shareholders, then failure to obey the rule becomes, under the decisions below, a fraud against the employer and a criminal violation of Rule 10b–5. The results which flow from the decisions below are thus irrational and dubious as a matter of public policy.

D. The Securities Fraud Convictions Violate Due Process Because a Reasonable Employee Could Not Know that a Breach of The Journal's Workrule Is a Crime

The expansion of the "misappropriation theory" has created confusion as to what constitutes lawful conduct.[41] Congress has done nothing to date to eliminate the uncertainties that

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39. *See Walton v. Morgan Stanley & Co.*, 623 F.2d 796 (2d Cir. 1980).

40. On the other hand, Blundell could lawfully have traded the stock under the decision below if he did not expose the fraud to the public and did *not* write an article; it was only because of his forthcoming article that his trading would violate the Journal's internal policy. This disincentive to reporting raises the very concern expressed by this Court in *Dirks* concerning the adverse impact of the Commission's position on the dissemination of information to the public. 463 U.S. at 661–63.

41. *See* Brief of the Securities Industries Association, Inc. as *amicus curiae* in support of petitioners' petition for writ of certiorari in this matter, stating that its members are now unable to know with any certainty whether transactions that they effect may constitute a breach of some non–securities related duty owed by a client to a third party, which breach may subject its members to criminal or civil liability under the federal securities laws.

exist, although there has been ample opportunity to enact such legislation. During hearings on the Insider Trading Sanctions Act of 1984, Pub. L. 98–376, 98 Stat. 1264 (Aug. 10, 1984) (codified as amended at 15 U.S.C. §§ 78c, 78o, 78t, 78u, 78ff), Congress was urged to clarify what constitutes the illegal use of material non–public information,[42] but others preferred imprecision. The then SEC Enforcement Director gave to Congress six reasons for a definition of insider trading and six reasons against, before ultimately opposing any definition because it might not allow as broad an application of the securities laws as was possible under the current vague rule.[43] In passing the Insider Trading Sanctions Act, Congress did not enact a definition. More recently, because of the substantial confusion concerning Rule 10b–5, proposals have been submitted in Congress that define the contours of "insider trading."[44] The Commission, however, has expressed a preference to determine what constitutes "insider trading" on a case–by–case basis and to define "new" types of violations after the conduct in question has occurred. As stated by the Chairman of the Commission, "[w]e are judge, jury and prosecutor."[45]

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42. Freeman, *The Insider Trading Sanctions Bill – A Neglected Opportunity*, 4 Pace L. Rev. 221 (1984); Freeman, *Legislative Action Called "Desirable" for Resolution of Insider Trading Problems*, N.Y.L.J., Dec. 14, 1981.

43. The Insider Trading Sanctions Act of 1983: Hearings on H.R. 559 Before the Subcommittee On Banking, Housing and Urban Affairs, 98th Cong., 2d Sess. (1984) (statement of John Fedders, SEC Enforcement Director).

44. *See* S. 230, 100th Cong., 1st Sess. (1987). Senator D'Amato, recognizing this Court's criticism of the Commission's case–by–case approach to insider trading as "inherently imprecise" and thus preventing "parties from ordering their actions in accord with legal requirements," introduced legislation that would provide for a definition of insider trading. 133 Cong. Rec. S. 474 (daily ed. Jan. 6, 1987) (statement of Senator D'Amato, quoting *Dirks*, 463 U.S. at 652 n.17, 654 n.24). *See also* ABA Committee on Federal Regulation of Securities, Report of the Task Force on Regulation of Insider Trading – Part I: Regulation under the Antifraud Provisions of the Securities Exchange Act of 1934, 41 Bus. Law. 223, 235–37, 253–63, 270–71 (1985).

45. Williams, *What's Legal — And What's Not*, Fortune, Dec. 22, 1986 at 36 (quoting Commission Chairman John S. R. Shad).

A crucial and necessary function of criminal law is to advise citizens of what conduct is permissible and what conduct is not. "[B]ecause we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972); *see also United States v. L. Cohen Grocery Co.*, 255 U.S. 81, 88–89 (1921).

This basic principle of our system of justice has sometimes been offended by a tendency in securities cases to expand the vague contours of Rule 10b–5 retroactively, in order to impose criminal sanctions on conduct never before proscribed. Dissenting from the Second Circuit's affirmance of the criminal conviction in *Chiarella*, Judge Meskill warned that the judicial "lawmaking function is severely restricted in the criminal area." 588 F.2d at 1376. This Court vindicated Judge Meskill's view, noting that "a judicial holding that certain undefined activities 'generally are prohibited' by section 10(b) would raise questions whether either criminal or civil defendants would be given fair notice that they have engaged in illegal activity." 445 U.S. at 235 n.20.

Here, the application of the undefined "misappropriation theory" to petitioners' conduct transgresses doctrines of fair notice, lenity and strict construction which are essential in the criminal law. *Rewis v. United States*, 401 U.S. 808, 812 (1971). Flexible interpretations of regulatory statutes consonant with the broad remedial purposes of such legislation, though proper in the context of civil enforcement, are impermissible in criminal prosecutions.

The offense to due process is egregious in this case because no one knows what constitutes a criminal "misappropriation" under Rule 10b–5. Is it sufficient that use of lawfully acquired information contravene an implied term of an employment contract? Does it require breach of a fiduciary duty? Do all employees owe such duties to their employers, or only certain kinds of employees, or only employees in certain

kinds of professions, or only with respect to certain kinds of information?[46]

The courts below held that Winans "misappropriated" the Journal's publication schedule. But what does it mean to "misappropriate" knowledge? Winans did not deprive Dow Jones of the use or value of the information he obtained.[47] He learned of the information in the regular performance of his job, not by stealth or other dishonest means.[48] In contrast to all prior "misappropriation" cases, Winans did not use the information in a manner legally forbidden to his employer.[49] Finally, as we noted at pages 19–21, *supra*, in all prior "misappropriation" cases, a duty was owed, if only derivatively, to a market participant.

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46. The Dow Jones conflicts of interest policy, both in its express language and as presented to employees, went "beyond the requirements of the law." *See* note 10, *supra*. Criminal prosecution of an employee for conduct violative of a company policy which has been presented to the employee as a *non–crime* offends the essence of fairness and is an "indefensible form of entrapment." *Cox v. Louisiana*, 379 U.S. 559, 571 (1965).

47. *Cf. Dowling v. United States*, 105 S. Ct. 3127, 3133–34 (1985), where the Court observed that unlawful use of copyrighted material

> does not easily equate with theft, conversion or fraud . . . . The infringer invades a statutorily defined province guaranteed to the copyright holder alone. But he does not assume physical control over the copyright; nor does he wholly deprive its owner of its use. While one may colloquially link infringement with some general notion of wrongful appropriation, infringement plainly implicates a more complex set of property interests than does run–of–the–mill theft, conversion, or fraud. As a result, it fits but awkwardly with the language Congress chose — "stolen, converted or taken by fraud" — to describe the sorts of goods whose interstate shipment § 2314 makes criminal.

48. Professor Keeton, summarizing the common law of fraud by nondisclosure just two years after the enactment of section 10(b), observed that unequal information in a business transaction does not amount to fraud where the information is lawfully (though unfairly) *acquired*. Keeton, *Fraud — Concealment and Non–Disclosure*, 15 Tex. L. Rev. 1, 35 (1936).

49. *See, e.g., Chiarella*, 445 U.S. 222; *Newman*, 664 F.2d 12; *Materia*, 745 F.2d 197; *Musella*, 578 F. Supp. 425.

Once the requirement of "duty between the parties to a transaction" is eliminated from the jurisprudence of section 10(b), there are many places where the line between lawful and unlawful conduct may be drawn.[50] This plethora of possibilities, and the policy choices inherent in each, requires that the lines be drawn by Congress and not the courts.[51]

By using the federal securities laws to impose criminal penalties for breaches of internal corporate policy under a vague and undefined theory of "misappropriation", the Second Circuit has caused tremendous confusion as to what relationships and what types of information are covered by section 10(b) and Rule 10b–5.[52] This expansion of the securities laws to indefinite

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50. This Court and the Commission itself have long recognized that not all unfairness in the markets violates a law which only "catches" fraud. *Chiarella*, 445 U.S. at 235. As this Court has stated:

> We do not suggest that knowingly trading on inside information is ever "socially desirable or even that it is devoid of moral considerations." [Citation omitted] . . . Depending on the circumstances, and even where permitted by law, one's trading on material non–public information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1 pp. 237–238 (1963).

Dirks, 463 U.S. at 661 n.21.

51. *See Dowling*, 105 S. Ct. at 3139. *See also* Note, *The Inadequacy of Rule 10b–5 to Address Outside Trading by Reporters*, 38 Stan. L. Rev. 1549, 1558–59 (1986).

52. *See, e.g.*, Arkin, *Insider Trading. Distinguishing Unequal Advantage from Fraud*, N.Y.L.J., June 19, 1986, at 1, cols. 3–4; Herzel & Katz, *Insider Trading Cases: Right Result, Wrong Rules*, Legal Times, June 23, 1986, at 15; *Insider Trading: Outside Which Law?*, Economist, June 14, 1986, at 76; Karmel, *Market Information: Insider Trading*, N.Y.L.J., June 19, 1986, at 1, col. 1; Klein, *Winans Decision Defies Doctrinal Shift*, Legal Times, June 23, 1986, at 15; Lewin, *Some Assert S.E.C. Pushes Too Far*, N.Y. Times, July 21, 1986, at D–1, col. 3; Marcus, *Murky Insider–Trading Rules Often Point to Outsiders*, Washington Post, June 1, 1986; Obermaier, *Who's an Insider? What's Inside?*, N.Y.L.J.,

boundaries in a criminal case creates the danger, realized here, that people will go to prison for conduct defined as criminal only in retrospect.

POINT II
THE MAIL AND WIRE FRAUD STATUTES DO NOT EXTEND TO SIMPLE BREACHES OF PRIVATE WORKRULES, INTANGIBLE INJURIES, AND INCIDENTAL MAILINGS AND WIRINGS

In summarily affirming petitioners' mail and wire fraud convictions, the Second Circuit took a further, and major, step in the 'recent . . . extraordinary expansion of mail and wire fraud statutes"[53] to create, by judicial fiat, "a new crime – corporate improprieties – which entails neither fraud nor even a victim. . . ."[54] Because petitioners' conduct was not a fraud at all, or at least not a criminal fraud falling within the ambit of the mail fraud and wire fraud statutes, their convictions should be reversed.

The trend toward a "seemingly limitless"[55] expansion of the mail and wire fraud statutes has been severely criticized in dissenting opinions in the Second Circuit,[56] in majority,

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July 1, 1986, at 1, col. 1; Williams, *What's Legal — And What's Not*, Fortune, Dec. 22, 1986, at 36–37 ("The SEC has a manhunt on for inside traders. But the rules are so vague that it's hard for arbitragers — and managers — to know if and when they have sinned."); Editorial, "SEC v. ?", Wall Street J., Nov. 20, 1986, at 34, col. 1 ("The problem with the SEC is that the crime it presumably is pursuing, 'insider trading', has for some time now lacked clear definition. No wonder the markets are uncertain . . see[ing] cases trying to further stretch the definition of 'insider' trading . . . since such an expansion would reduce, rather than expand, the amount of information available to the market").

53. *United States v. Weiss*, 752 F.2d 777, 791 (2d Cir.), *cert. denied*, 106 S. Ct. 308 (1985) (Newman, J., dissenting).

54. *United States v. Siegel*, 717 F.2d 9, 24 (2d Cir. 1983) (Winter, J., dissenting).

55. *Id.* at 14; *United States v. Margiotta*, 688 F.2d 108, 120 (2d Cir. 1982), *cert. denied*, 461 U.S. 913 (1983); *United States v. Von Barta*, 635 F.2d 999, 1001 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981).

56. *See, e.g.*, *Weiss*, 752 F.2d at 791–95 (Newman, J., dissenting);

concurring and dissenting opinions in other circuits,[57] and by the near–unanimous weight of scholarly opinion.[58] It has never been

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Siegel, 717 F.2d at 23–24 (Winter, J., dissenting); *Margiotta*, 688 F.2d at 139–44 (Winter, J., dissenting); *United States v. Bronston*, 658 F.2d 920, 930–33 (2d Cir. 1981) (Van Graafeiland, J., dissenting), *cert. denied*, 456 U.S. 915 (1982). *See also United States v. Pisani*, 773 F.2d 397, 410–11 (2d Cir. 1985) (reversing mail fraud conviction based on fiduciary breach); *United States v. Dixon*, 536 F.2d 1388, 1398–1401 (2d Cir. 1976) (Friendly, J.) (reversing mail fraud conviction held to be "a considerable distance from the ordinary meaning of 'scheme or artifice to defraud'"). Many of the Second Circuit decisions extending the mail and wire fraud statutes reversed decisions by thoughtful district judges who, even within the confines of prior Second Circuit precedents, did not believe that the statutes could be further stretched. *See, e.g., United States v. Courtois*, [1981] Fed. Sec. L. Rep. (CCH) ¶ 98,024 (S.D.N.Y.) (Haight, J.), *rev'd on other grounds sub nom. United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983); *Von Barta*, 635 F.2d at 999 (reversing dismissal of indictment by Brieant, J.).

57. *United States v. Hewes*, 729 F.2d 1302, 1322 (11th Cir. 1984), *cert. denied sub nom. Caldwell v. United States*, 469 U.S. 1110 (1985); *United States v. Lemire*, 720 F.2d 1327, 1335–36 (D.C. Cir. 1983) (majority opinion expressing "second thoughts" about expansion of mail fraud, and rejecting government's theory that "would criminalize any intentional undisclosed breach of duty to an employer"), *cert. denied*, 467 U.S. 1226 (1984); *United States v. Curry*, 681 F.2d 406, 418–25 (5th Cir. 1982) (Garwood, J., concurring) (expressing disagreement with "intangible rights" theory of mail fraud); *United States v. Ballard*, 663 F.2d 534 (5th Cir. 1981), *modified on reh'g*, 680 F.2d 352 (5th Cir. 1982) (requiring prosecution to prove actual financial loss to corporate employer where employee breached conflict of interest rules); *United States v. Rabbitt*, 583 F.2d 1014 (8th Cir. 1978), *cert. denied*, 439 U.S. 1116 (1979); *United States v. Craig*, 573 F.2d 455, 497–505 (7th Cir. 1977) (Swygert, J., dissenting) (describing the extension of the mail and wire fraud statutes as a "pernicious trend"), *cert. denied*, 439 U.S. 820 (1978); *United States v. Caldwell*, 544 F.2d 691, 697–98 (4th Cir. 1976) (Widener, J., concurring) (suggesting limitation of mail fraud prosecutions to tangible injuries); *United States v. McNeive*, 536 F.2d 1245 (8th Cir. 1976); *United States v. States*, 488 F.2d 761, 767 (8th Cir. 1973) (Ross, J., concurring), *cert. denied*, 417 U.S. 909 (1974); *United States v. Edwards*, 458 F.2d 875, 880 (5th Cir.), *cert. denied sub nom. Huie v. United States*, 409 U.S. 891 (1972); *United States v. Kelem*, 416 F.2d 346, 347 (9th Cir. 1969), *cert. denied*, 397 U.S. 952 (1970).

58. *See, e.g.*, Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 Am. Crim. L. Rev. 117 (1981) (hereinafter "*From Tort to Crime*") (criticizing the entire development of the mail and wire fraud stat-

reviewed by this Court. But, as we demonstrate below, the continuation of the trend in this case not only "eliminate[s] the need to show a substantial connection between the scheme to defraud and the use of the mails or wires . . . [b. ven] the need to show fraud" itself.[59] It flies in the face of the statutory language and contradicts this Court's earlier decisions construing these statutes.

On their face, the mail and wire fraud statutes simply prohibit a person from causing the use of the mails or interstate wires for the purpose of executing a scheme to defraud or for obtaining money or property by fraudulent means.[60] But where the statutes speak of a "scheme . . . to defraud," lower courts — and the courts here — have substituted a "breach of fiduciary duty."[61] Where the statutes speak of "obtaining money or

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utes, especially as applied in *Bronston*); Jeffries, *Legality, Vagueness and the Construction of Penal Statutes*, 71 Va. L. Rev. 189, 190–201 (1985) (criticizing as "case-by-case criminalization" the extension of the mail fraud statute to fiduciary breaches as applied in *Margiotta*); Morano, *The Mail-Fraud Statute: A Procrustean Bed*, 14 J. Marshall L. Rev. 45 (1980); Tigar, *Mail Fraud, Morals and U.S. Attorneys*, 11 Litigation 22 (Fall 1984); Note, *Intra-Corporate Mail and Wire Fraud: Criminal Liability for Fiduciary Breach*, 94 Yale L.J. 1427 (1985) (criticizing as "untenable" the mail fraud fiduciary breach standard as applied in *Siegel* and *Weiss*); Comment, *Federal Prosecution of Elected State Officials for Mail Fraud: Creative Prosecution or An Affront to Federalism*, 28 Am. U.L. Rev. 63 (1978). *See also* Coffee, *The Metastasis of Mail Fraud: The Continuing Story of the "Evolution" of a White-Collar Crime*, 21 Am. Crim. L. Rev. 1 (1983) (hereinafter "*The Metastasis of Mail Fraud*"); Hurson, *Limiting the Federal Mail Fraud Statute — A Legislative Approach*, 20 Am. Crim. L. Rev. 423 (1983); Comment, *The Intangible-Rights Doctrine and Political-Corruption Prosecution Under the Mail Fraud Statute*, 47 U. Chi. L. Rev. 562, 578 (1980).

59. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting).

60. 18 U.S.C. §§ 1341, 1343 (1982). Identical principles govern the construction and application of the two statutes. *See, e.g., Siegel*, 717 F.2d at 14 and cases there cited.

61. *See, e.g., Siegel*, 717 F.2d at 14; *Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *Bronston*, 658 F.2d at 926; *United States v. Mandel*, 591 F.2d 1347 (4th Cir.), *aff'd on hearing en banc*, 602 F.2d 653, *cert. denied*, 445 U.S. 961 (1980); *United States v. Isaacs*, 493 F.2d 1124 (7th Cir.), *cert. denied*, 417 U.S. 976 (1974); *Post v. United States*, 407 F.2d 319 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 1092 (1969).

property," lower courts — and the courts here — have substituted doing injury to "intangible rights" such as "honesty," "loyalty," "privacy," "reputation," "time," "effort," or "expectations."[62] And where the statutes speak of "causing" a use of the mails or wires for the "purpose of executing" the fraud, lower courts — and the courts here — have substituted any use (purposeful or otherwise) that is an incidental accompaniment of the events growing out of the "fraud."[63]

The Second Circuit's opinion in this case represents the culmination of each of these trends. The petitioners' mail and wire fraud convictions are based entirely on (A) simple breaches of private workrules and company conflict codes, (B) intangible injuries, and (C) incidental mailings and wirings. Because the proper scope of the mail and wire fraud statutes cannot be stretched so far, petitioners' convictions should be reversed.

A. Breaches of Private Workrules and Company Conflict Codes

Winans' misconduct was his breach of the Journal's "Conflicts of Interest Policy." From the outset, the "government concede[d] that without any [such] policy there could be no prosecution" here.[64] Of the various "guidelines" set out in the policy,[65] two were violated by Winans: guideline (i), a general prohibition against the prepublication disclosure ("leaking") to anyone outside the company of "any material gleaned by [the

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62. *See, e.g., Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *Von Barta*, 635 F.2d at 1005–06; *United States v. Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980); *United States v. Condolon*, 600 F.2d 7, 9 (4th Cir. 1979); *United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896 (1978); *United States v. Keane*, 522 F.2d 534, 544 (7th Cir. 1975), *cert. denied*, 424 U.S. 976 (1976).

63. *See, e.g., United States v. Green*, 786 F.2d 247 (7th Cir. 1986); *United States v. Muni*, 668 F.2d 87 (2d Cir. 1981).

64. 612 F. Supp. at 842; 58a.

65. The policy itself was set forth in the last few pages of a 44-page pamphlet entitled "The Inside Story," which was distributed to new employees of Dow Jones. GX 54; *see* 612 F. Supp. at 829; 35a.

employee] in the course of the employee's work," all of which material was "deemed to be strictly the Company's property";[66] and guideline (iii), a specific prohibition against prepublication trading in securities of any company that the employee knew was the subject of a forthcoming article.[67] Although only Winans was found to be specifically aware of both of these guidelines,[68] both Carpenter and Felis were held criminally accountable for having reaped benefits from Winans' breaches.[69]

Almost without any analysis or discussion, the Second Circuit held that Winans' breach of these internal guidelines and policy, *per se*, constituted a scheme to defraud cognizable under the mail and wire fraud statutes. Specifically, the court held that "the scheme to misappropriate material nonpublic information regarding the Journal's forthcoming publications in breach of the employee's [fiduciary] duty of confidentiality to the Journal in connection with securities transactions met the requirements" of these statutes.[70]

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66. GX 55; App. 41–42. Of course, the Journal, like all newspapers, had no ethical compunction about soliciting "leaks" from the employees of other institutions, public or private, regardless of those institutions' internal rules.

67. GX 55; App. 42.

68. 612 F. Supp. at 831; 37a. Carpenter was found to be "generally aware" of the "policy of confidentiality" embodied in the first guideline. *Id.* at 831; 38a.

69. On appeal to the Second Circuit, Felis argued that in the absence of knowledge of the Journal's policies, he lacked the intent necessary to be found guilty of conspiring to defraud the Journal. Carpenter, who was acquitted of the conspiracy and found guilty of aiding and abetting Winans' personal trading in violation of guideline (iii), offered a similar argument based on the district court's finding that he only knew of guideline (i). The Second Circuit declined to address, other than summarily, either of these arguments.

70. 791 F.2d at 1035; 24a. At trial, the government initially suggested that mail and wire fraud liability could rest either on this "breach of fiduciary duty" theory or on a "misappropriation of information" theory. 612 F. Supp. at 844; 61a–62a. However, even assuming that the Journal's unilateral attempt to "deem" all information its property was controlling as a matter of law, *but see Dowling*, 105 S. Ct. at 3133, Winans' "misappropriation" of such information would be no more a scheme to defraud than any other theft

Packed into this brief holding are a series of assumptions, each one less supportable than the next. First, at common law and in the law of the several states, "it is far from clear that an employee owes any fiduciary duty to his employer."[71] Yet, following earlier expansive mail and wire fraud decisions, the Second Circuit here posits that the duty owed by an employee to his employer is that of a fiduciary, thereby imposing, upon pain of criminal liability, a higher, federal standard upon employer–employee relations. Second, the court below here assumes that an employee's fiduciary duty extends to every private workrule — even if imposed unilaterally by the employer and without regard to the employment contract — and that a failure to adhere to such rules with a fiduciary's punctiliousness deprives the employer of the full faith and loyalty required of a fiduciary. In so holding, the Second Circuit applies to workrule breaches an intangible injury theory that, as suggested by Judge Friendly in *United States v. Dixon*,[72] was "developed to fit the situation [of] . . . public officials," whose fiduciary duties might at least be said to be imposed by the state.[73] Third and finally, the Second Circuit here assumes that every such breach of a workrule carries with it an intrinsic duty to report the breach to the employer, such that a failure to so report is inherently deceptive and fraudulent *per se*. By such legerdemain, the court removes from the concept of criminal fraud its most central feature — actual deception — and replaces it with a notion of constructive fraud, once held the mark of civil liability

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unless it also constituted a fiduciary breach; hence, the government ultimately conceded that in the absence of a breach of the conflict of interest policy, there could be no conviction under the "misappropriation theory." *See supra* note 20. For similar reasons, both the district court (expressly) and the appellate court (implicitly) found that both the government's theories of mail and wire fraud liability merged into a single fiduciary breach theory. 791 F.2d at 1029; 24a; 612 F. Supp. at 844; 61a–62a.

71. *From Tort to Crime*, *supra* note 58, at 160.

72. 536 F.2d 1388 (2d Cir. 1976). *See also Courtois*, [1981] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,301.

73. *Dixon*, 536 F.2d at 1400. *See also Margiotta*, 688 F.2d at 121; *Bohonus*, 628 F.2d at 1171; *Keane*, 522 F.2d at 549. *Cf. United States v. Gray*, 790 F.2d 1290 (6th Cir.), *cert. granted*, 107 S. Ct. 642 (1986).

alone.[74]

Each of these assumptions carries the law of mail and wire fraud well beyond what is ordinarily recognized as fraud in the criminal law. The final assumption, moreover, goes further than any previous case. Prior to the instant case, most courts of appeals, however expansive a view they had taken of mail and wire fraud, had at least required that a breach of duty be linked with an independent material misrepresentation to the person to whom the duty was owed.[75] However, while the lower courts here paid lip–service to this requirement,[76] Winans in fact neither made any misrepresentations to the Journal nor failed to comply with any express duty to disclose his trading and leaks. Rather, he simply breached the conflicts of interest workrules themselves. By reading implicit deception into those workrule breaches, the Second Circuit silently adopts precisely the "bootstrap" approach to mail and wire fraud that it condemned in *Newman*, its prior precedent most closely in point,[77] and that is routinely condemned by federal courts in interpreting the securities laws.[78]

Under the principles announced by the lower courts' opinions and applied to petitioners in this case, disobedience of any internal workrule gives rise to a mail or wire fraud violation, no

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74. *Cf. Von Barta*, 635 F.2d at 1005 n.14 ("Constructive frauds involve breaches of fiduciary or equitable duties where intent to deceive is lacking [citation omitted]. Only actual frauds are within the purview of the mail fraud statute.").

75. *See, e.g., Von Barta*, 635 F.2d at 1005 n.14, 1006–07; *United States v. Bush*, 522 F.2d 641, 648 (7th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976); *Epstein v. United States*, 174 F.2d 754 (6th Cir. 1949). *See also The Metastasis of Mail Fraud, supra* note 58, at 14.

76. 791 F.2d at 1035; 24a; 612 F. Supp. at 844; 62a.

77. *Newman*, 664 F.2d at 19. The district court itself recognized that "it is a bit absurd to say that an element of Winans' crime was that he did not tell the Wall Street Journal that he was committing it." 612 F. Supp. at 844 n.13; 62a n.13.

78. *See, e.g., Atchley v. Qonaar Corp.*, 704 F.2d 355, 358 (7th Cir. 1983); *Staffin v. Greenberg*, 672 F.2d 1196, 1205 (3d Cir. 1982); *Biesenbach v. Guenther*, 588 F.2d 400, 402 (3d Cir. 1978); *Warner Communications, Inc. v. Murdoch*, 581 F. Supp. 1482, 1490 (D. Del. 1984).

matter how technical the rule or trivial the conduct it prohibits, even where there is no discernible federal interest in regulating the employment relationship. It does not matter that the workrule has been, as here, imposed unilaterally by the employer,[79] and made known to the employee (if at all) only after employment has commenced. Nor does it matter that the rule has no specific correlative in criminal law[80] or even in common industry practices.[81] Violation of such rule now constitutes grounds not only for discharge but also for federal criminal prosecution. Indeed, even a former employee who has no better than a "general awareness" of the workrule (Carpenter)[82] or an outsider who has no awareness of the rule whatever (Felis)[83] can be criminally prosecuted if he assists the employee in the activities that violate the workrule.

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79. The Journal's workrules were neither quoted nor referred to in the collective bargaining agreement governing Winans' employment (Exhs. WU–1, WU–2; T. 121).

80. Although the majority opinion, 791 F.2d at 1033 n.11; 21a n.11, refers to certain state criminal statutes prohibiting theft of trade secrets, these laws are carefully limited, in New York as elsewhere, to the narrowly defined category of "secret scientific material." N.Y. Penal Law § 165.07 (McKinney 1975 & Supp. 1986). *See also id.* § 155.00 [subd. 6]. The opinion also makes reference to *civil* liability for breach of confidentiality, 791 F.2d at 1028, 1033, 10a, 21a; but even accepting the questionable assumption that an employee would incur civil liability for disclosing a newspaper's publication schedule to a non–competitor, the relevant point is that the state legislature has chosen to protect criminally only a narrow area, not including the information here disclosed. Thus do the lower courts' decisions override the state legislature's determination.

81. According to the Journal, workrules restricting a reporter's trading of securities are the exception rather than the rule. *See Media Policies Vary on Preventing Employees and Others from Profiting on Knowledge of Future Business Stories*, Wall Street J., March 2, 1984 (Exh. WSJ–9; App. 35).

82. 612 F. Supp. at 831; 38a; *see United States v. Frade*, 709 F.2d 1387, 1392 (11th Cir. 1983) ("The finding that a defendant is aware that his conduct is generally unlawful is insufficient to sustain a finding of guilt under a statute requiring specific intent").

83. *See Ballard*, 663 F.2d at 543 (reversing conviction of mail fraud, conspiracy and aiding and abetting when there was no evidence that defendants knew of the duty owed by codefendant principal).

The decision below thus gives every employer the power to decide what acts are indictable as felonies and usurps a role heretofore reserved to the legislature.[84] Moreover, the practical effect of criminalizing every workrule breach is to give prosecutors almost total discretion in determining, after the fact, what conduct constitutes a crime and who should be criminally prosecuted.[85]

This Court has noted that the phrase "breach of fiduciary duty" "only begins an analysis" rather than provid s guidance or certainty.[86] Yet, the decisions below and their immediate precedents effectively "read the [mail and] wire fraud statute[s] to embody a federal law of fiduciary obligations, including an undefined duty of yet further disclosure, enforceable by the sanctions of criminal law."[87] The Second Circuit's decision does not limit the power to criminalize private rules to breaches of employer workrules, but creates a federal felony wherever there may be said to be a "breach of fiduciary duty." This should no more be permitted under the mail and wire fraud statutes than under the comparable language of the securities fraud statutes.[88]

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84. Under the Second Circuit's analysis, it is irrelevant that the "private policy" elevated to the status of criminal law purports to govern conduct involving the purchase and sale of securities, which is the subject of thorough Congressional scrutiny and a detailed statutory scheme, including the Securities Act, the Exchange Act, and the Investment Advisors Act. Even if the specific conduct proscribed by private company policy had been considered by Congress and deemed lawful, violation of the policy — if it involved the requisite wire or mailing — would be a federal wire or mail fraud. *Cf. United States v. Henderson*, 386 F. Supp. 1048, 1053–54 (S.D.N.Y. 1974) (Weinfeld, J.).

85. *See* Jeffries, *supra* note 58, at 190–201.

86. *SEC v. Chenery Corp.*, 318 U.S. 80, 85–86 (1943) (Frankfurter, J.) *See also Bronston*, 658 F.2d at 931 (Van Graafeiland, J., dissenting). The difficulties faced by the district courts in discerning the new criminal reach of "fiduciary duty" are made forcefully apparent in *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y.) (mail fraud indictment of son for alleged breach of fiduciary duty to father), *rev'd on other grounds*, 773 F.2d 477 (2d Cir. 1985).

87. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting). *See also Margiotta*, 688 F.2d at 124 (dictum).

88. *See Chiarella*, 445 U.S. at 234–35.

By criminalizing every fiduciary breach, the lower courts' decisions work a vast interference with state laws defining the boundaries of employer–employee relations. As Professor Coffee has stated:

> [B]efore one accepts the equation that a knowing fiduciary breach equals a "scheme to defraud," some troubling consequences of this proposition need to be considered. [These include, among others, that]: . . . significant differences exist among state jurisdictions in terms of the duties that fiduciaries owe, thereby possibly creating significant disparities in the coverage of federal criminal law depending on the applicable state civil law; . . . if the result of the criminalization of fiduciary breaches is also their federalization, this conflicts with the principle of deference to state corporate law which recent Supreme Court decisions have established; . . . [and] the "internal affairs" rule of corporate law under which the law of the jurisdiction of incorporation controls as to all intra–corporate disputes seems irreconcilable with the policies underlying the traditional criminal law rule that one jurisdiction will not enforce the penal statutes of another.[89]

No clear mandate of Congress authorized this unbridled exercise of judicial discretion, overcriminalization of ordinary workrule breaches, and interference with state fiduciary requirements. Rather, they arose through a progression of expansive interpretations by courts bent on punishing not just those who have committed fraud in the traditional sense, but also those who simply "fail to match the reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society."[90] Such

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89. *From Tort to Crime*, *supra* note 58, at 150.

90. This is the standard of "fraud" under the mail and wire fraud statutes set forth in *Blachly v. United States*, 380 F.2d 665, 671 (5th Cir. 1967).

judicial overextension makes a mockery of this Court's recent reminder in *Dowling* that:

> Due respect for the prerogatives of Congress in defining federal crimes prompts restraint in this area, where we typically find a "narrow interpretation" appropriate. *See Williams v. United States*, 458 U.S. 279, 290 (1982). Chief Justice Marshall early observed: "The rule that penal laws are to be construed strictly, is perhaps not much less old than construction itself. It is founded on the tenderness of the law for the rights of individuals; and on the plain principle that the power of punishment is vested in the legislative, not in the judicial department. It is the legislature, not the Court, which is to define a crime, and ordain its punishment." *United States v. Wiltberger*, 5 Wheat. 76, 95, 5 L.Ed. 37 (1820).[91]

B. Intangible Injuries

Dowling also instructs that "when assessing the reach of a federal criminal statute, we must pay close heed to language, legislative history, and purpose in order strictly to determine the scope of the conduct the enactment forbids."[92] The language, history and purpose of the mail and wire fraud statutes strongly suggest that Congress intended that they extend only to those fraudulent schemes that inflict pecuniary or property injury.[93] When the mail fraud statute was enacted in 1872, it embodied a notion of fraud defined at common law to cover only the obtaining of money or property by affirmatively false statements of

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and subsequently adopted in numerous other mail and wire fraud cases. *E.g., Bohonus*, 628 F.2d at 1171; *Keane*, 522 F.2d at 545; *United States v. States*, 488 F.2d at 764; *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958).

91. *Dowling*, 105 S. Ct. at 3132.

92. *Id.* at 3131–32.

93. *See United States v. Regent Office Supply Co.*, 421 F.2d 1174, 1181–82 (2d Cir. 1970).

existing facts."[94] Twice since then this Court has had occasion to caution against extending the statute beyond "pecuniary or property injury inflicted by a scheme to use the mails for the purpose."[95]

Nevertheless, a series of lower court decisions, as yet unreviewed by this Court, has permitted the substitution of intangible injuries for the tangible or economic injuries contemplated by the statute. Thus, as noted, the statutory requirement of a scheme to defraud has been held to be satisfied by a scheme to deprive a person of such intangibles as "time," "effort," and "expectations."[96] Likewise, the requirement of a specific intent to inflict harm[97] has been held to be satisfied by an intent to injure such intangible interests as "honesty," "loyalty," and "privacy."[98]

The instant decision extends this line of cases to new extremes by invoking no less than three different kinds of intangibles to satisfy various elements of the mail and wire fraud statutes. First, the courts below held that the statutory requirement of obtaining money and property was satisfied by Winans' obtaining of information, specifically the publication schedule of

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94. So narrow was the statute that it required a decision of this Court, *Durland v. United States*, 161 U.S. 306 (1896), and an amendment by Congress, Act of March 4, 1909, ch. 321, § 215, 35 Stat. 1130, to make clear that the statute also reached the obtaining of money or property by false pretenses, representations, or promises as to the future. *See Comment*, 47 U. Chi. L. Rev., *supra* note 58, at 578; Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. 771, 811, 816 (1980); Pearce, *Theft by False Promises*, 101 U. Pa. L. Rev. 967, 980 (1953). *See also United States v. Frankel*, 721 F.2d 917, 919–20 (3d Cir. 1983).

95. *Fasulo v. United States*, 272 U.S. 620, 628–29 (1926); *Hammerschmidt v. United States*, 265 U.S. 182, 189 (1924). *See also Ballard*, 663 F.2d at 534; *United States v. Curry*, 681 F.2d 406, 418 (5th Cir. 1982) (Garwood, J., concurring); *United States v. Caldwell*, 544 F.2d 691, 697 (4th Cir. 1976) (Widener, J., dissenting).

96. *Condolon*, 600 F.2d at 9.

97. *Regent Office Supply*, 421 F.2d at 1180–82; *Dixon*, 536 F.2d at 1399 n.11.

98. *Curry*, 681 F.2d at 410; *Bohonus*, 628 F.2d at 1172; *Keane*, 522 F.2d at 547.

Heard columns. The courts below analogized this to the theft of commercially valuable information;[99] but the analogy is flawed. Here, unlike in other cases cited by the lower courts, use of the information in question did not detract from the economic value of the information to the person from whom it was supposedly being misappropriated, the Journal.

Second, as already noted, the lower courts held that the element of deception necessary to make the misappropriation of information a fraud was satisfied by Winans' breach of his duty of "honest and faithful service" to the Journal, in the form of his undisclosed breach of the confidentiality policy.[100] This, of course, is the necessary complement to the "fiduciary breach" theory of mail fraud: it is only because these courts have held an employer's "intangible right" to his employee's "full faith and loyalty" to be a protected interest under the mail and wire fraud statutes that an employee's breach of this "fiduciary" duty of loyalty can even arguably be said to state an injury, and the nondisclosure of the breach a deception, under these statutes. As summarized by Professor Coffee:

> Critical to this doctrine's significance is its assertion that the nondisclosure of a conflict of interest by a person characterizable as a fiduciary can amount to a deprivation of the "honest and faithful services" owed by the fiduciary to the beneficiary. As a practical matter, the operative effect of this disclosure requirement is to simplify the prosecutor's case by substituting proof of nondisclosure for proof of loss or illicit gain. At the same time, the protean character of the term "fiduciary" has enabled the prosecutor to reach areas that Congress never contemplated would be subject to federal criminal sanctions.[101]

99. 791 F.2d at 1034; 23a.

100. 612 F. Supp. at 844 n.13; 62a n.13.

101. *The Metastasis of Mail Fraud*, *supra* note 58, at 1-2.

Third and finally, while the prosecution was unable to firmly establish that Winans' breaches caused any harm, economic or otherwise, to the Journal,[102] the lower courts held that the requirement that the defendant contemplate actual harm to his victim[103] was satisfied here by the fact that Winans' leaks and trading placed the Journal's "reputation for professionalism" in potential jeopardy.[104] As one commentator has noted, "this is a strange sort of harm, for it occurs only if the scheme is discovered."[105] Nor is it easily squared with this Court's earlier rejection of blackmail as a basis for mail fraud prosecution and its insistence on tangible economic injury.[106] Moreover, it must be recalled that the Journal never even apprised its readers of the existence of its policy prior to the Winans incident[107] and, accordingly, had never invited readership reliance on any such policy or public expectation that such a policy was in place. It simply makes no sense to posit that the Journal might have suffered a lowering of public esteem for one reporter's failure to comply with a policy which the public did not know about and had no reason to believe existed, and which the law did not require the company itself to follow.

Aside from the total absence of any finding or evidence that petitioners intended reputational harm,[108] the simple truth is that if a concept as loose as "reputation for professionalism" can satisfy the harm requirement of the mail and wire fraud statutes, then the requirement has effectively been eliminated *sub silentio*. Such a doctrine sweeps within the ambit of the mail and wire fraud statutes entire areas of minor wrongs and peccadilloes that have never been held to warrant the invocation

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102. 612 F. Supp. at 845; 63a–64a.

103. *See, e.g., Regent Office Supply*, 421 F.2d at 1180–82.

104. 791 F.2d at 1035; 24a.

105. Langevoort, *The Insider Trading Sanctions Act of 1984 and Its Effect on Existing Law*, 1985 Sec. L. Rev. 187, 210 n.113.

106. *Fasulo*, 272 U.S. at 628–29; *Hammerschmidt*, 265 U.S. at 189.

107. T. 115–16, 159; Exh. WSJ–9; App. 35.

108. Instead of finding actual harm or intent to harm, the district court merely *presumed* harm from the alleged fiduciary breach itself. 612 F. Supp. at 845–46; 64a–65a.

of criminal sanctions in any jurisdiction, let alone classification as a federal felony. In fact, the sole interest protected by this prosecution — a newspaper's reputation[109] — is not the kind of interest that has historically been held to warrant the invocation of society's severest sanction, criminal penalties. Just as "[h]arm to reputation . . . never has been recognized as a proper subject for redress under section 10(b) or rule 10b–5,"[110] so too it has never before been recognized as a proper subject for redress under the mail or wire fraud statutes.[111]

In short, a view that certain kinds of corrupt schemes by public officials can defraud the public of "intangible" but publicly–defined rights[112] has now expanded, well beyond the limits of its logic,[113] to where the vaguest kinds of interests and injuries can satisfy both the objective and subjective elements of

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109. 612 F. Supp. at 845; 64a.

110. 791 F.2d at 1037; 29a (Miner, J., dissenting).

111. In so stating, the dissent necessarily discounted the "sullying of reputation" language in *Newman*, 664 F.2d at 17, as pure dictum; but, in any event, this aspect of the *Newman* decision suffers from many of the same infirmities as the decision here. *Cf. Langevoort*, *supra* note 105, at 210 (suggesting that *Newman* comes close to eliminating the "deception" element of fraud required by this Court in *Santa Fe*, and that Second Circuit cases following *Newman* eliminate this requirement altogether, almost without analysis).

112. *See, e.g., Margiotta*, 688 F.2d at 121; *Isaacs*, 493 F.2d at 1150; *United States v. States*, 488 F.2d at 765; *Shushan v. United States*, 117 F.2d 110, 115 (5th Cir.), *cert. denied*, 313 U.S. 574 (1941). *Cf. Dixon*, 536 F.2d at 1400–01; *Aczel v. United States*, 232 F. 652 (7th Cir. 1916). The all–encompassing scope of "scheme to defraud" in cases involving corruption of state and municipal officials developed under the influence of the corresponding statute applicable to federal officials, now codified at 18 U.S.C. § 371 (1982), which proscribes conspiracy to defraud the United States. *See Haas v. Henkel*, 216 U.S. 462, 479 (1910), which provided "the most extreme expansion of the statute." Goldstein, *Conspiracy to Defraud the United States*, 68 Yale L.J. 405, 426 (1959).

113. *Cf. United States v. Borelli*, 336 F.2d 376, 380 (2d Cir. 1964) (Friendly, J.) ("the instant case . . . exemplifies, in Judge Cardozo's phrase, the 'tendency of a principle to expand itself to the limit of its logic' . . . and perhaps beyond"), *cert. denied sub nom. Cinquegrano v. United States*, 379 U.S. 960 (1965).

criminal fraud.[114] The result, in the words of one commentator, "has been both to extend the net of the federal criminal sanction over an extraordinarily vast terrain and to arm the federal prosecutor with a weapon substantially different in character from any previously known to the substantive criminal law."[115]

C. Incidental Mailings and Wirings

Not content with eliminating the last vestiges of the former mail fraud requirements of actual deception (see subsection A, *supra*) and economic injury (see subsection B, *supra*), the lower courts' decisions proceed to eliminate the requirement that the requisite mailings and wirings be in some sense caused by the defendants for the purpose of executing their fraudulent scheme. Indeed, the charged mailings and wirings — involving the printing of the Journal and its subsequent distribution — were entirely irrelevant to, and unaffected by, a "fraud" effected by pre-publication leaking and trading.

In holding that the mailings and wirings in this case were adequate because they were "important" to the success of the scheme and were "reasonably foreseeable" by the petitioners,[116] the lower courts' decisions ignored not only the relevant precedents of this Court[117] but also the statutory language itself, which requires that the petitioners "cause" the mailings or interstate wirings "for the purpose of executing" their fraudulent scheme. Winans' job was to write accurate columns for the Journal, which, along with the rest of the paper's text, were then conveyed by interstate wire communication (the predicate wirings) to the printing plant, from which the paper was distributed, partly by mail (the predicate mailings), to its

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114. Indeed, one major reason for the overexpansion of the mail and wire fraud statutes is that it has occurred piecemeal, with one panel building ever further on an earlier panel's decision without stepping back to examine the overall effect of the progression.

115. *The Metastasis of Mail Fraud*, *supra* note 58, at 1.

116. 791 F.2d at 1035; 24a–25a.

117. *United States v. Maze*, 414 U.S. 395, 400–05 (1974); *Parr v. United States*, 363 U.S. 370, 389–94 (1960); *Kann v. United States*, 323 U.S. 88, 94–95 (1944). *See also United States v. Lane*, 106 S. Ct. 725, 733–34 (1986).

subscribers. The alleged fraud did not change any of this one iota. Neither the timing nor the accuracy of the columns was affected; the wire transmission in form and content was exactly what it would have been in the absence of Winans' breach of the Journal's workrules. Nor were the mailings even directed to the alleged victim of fraud, the Wall Street Journal; indeed, on the theory of this prosecution, the "fraud" — consisting of Winans' unauthorized use of the Journal's publication schedule — was entirely completed before any relevant mailing or interstate wiring occurred.[118]

To be sure, the petitioners took advantage of the fact that Winans' columns would be printed and distributed to realize certain financial benefits from their arrangement.[119] But to equate this with the statutory requirement that they "cause" the mailings and wirings "for the purpose" of executing their scheme is to deprive the statutory words of their ordinary meaning, both individually, and, more importantly, in relation to one another. In no linguistically recognized or legal sense did the petitioners "cause" these mailings and wirings "for the purpose"

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118. This fact is evidenced most graphically by the government's contention that Winans' "fraud" occurred when he "leaked" information to Brant, and that an actual securities transaction was not required under its mail and wire fraud theory. Accordingly, Counts 43 and 61 of the indictment, involving Winans' prepublication disclosure of articles about Quotron (GX 30) and Chicago Milwaukee (GX 36), were upheld in the face of Fed. R. Crim. P. 29 motions to dismiss, notwithstanding the fact that no corresponding securities transactions were effected pursuant to the Winans/Brant/Felis arrangement (T. 1686–91; 1695–1703).

119. Almost every radio and television station in the country transmits interstate. Many, if not most, newspapers and magazines are mailed. Under the government's theory, if consistently applied, reporting of true, accurate and non–misleading information becomes a criminal fraud if assisted by a journalist or editor whose undisclosed self–interest (political, emotional, or economic) in the subject matter of the report — though it does not affect the accuracy of his reporting — could be a source of embarrassment to his employer. If such a rule is to become the law, this should be done only after the most careful and deliberate consideration by the Congress, and the adoption of specific guidelines and regulations which circumscribe and delimit the conduct sought to be proscribed in light of the chilling impact certain to emerge. It should not arise through a case–by–case development of federal common law or have its first application in a criminal case.

of furthering their scheme. While the substitute terminology relied on by the lower courts, that the mailings and wirings were "important" and "reasonably foreseeable," may sometimes substitute for "cause" in the context of determining general proximate causality, they cannot reasonably substitute for "causing-for-a-purpose." In the words of the Eighth Circuit:

> "We reiterate that in order to obtain a conviction under § 1341, the government must prove beyond a reasonable doubt that the defendant intentionally devised a fraudulent scheme and caused the use of the mails *for the purpose of carrying out the scheme*. We trust that these requirements will serve as a restraint on whatever tendency the government might have to prosecute anyone who ever bounced a check."[120]

To be sure, the Second Circuit is not alone in watering down this statutory mandate of purposeful causality. But this Court has always stood fast by the statutory language. As Judge Posner, in dissent, recently stated:

> The distinction between mailing a letter to execute a fraud and merely taking advantage of a criminal opportunity created by a letter sent for a lawful purpose is at the heart of *Parr v. United States*, 363 U.S. 370 (1960) . . . .
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> • • •
>
> Missing from both *Parr* and this case is a causal connection between the purpose and the mailings; the mailings would have occurred anyway. This point has been a ground of decision in other cases

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120. *United States v. Taylor*, 789 F.2d 618, 623 (8th Cir. 1986) (emphasis in original) (quoting *United States v. Freitag*, 768 F.2d 240, 244 (8th Cir. 1985)). *See also United States v. Castile*, 795 F.2d 1273 (6th Cir. 1986); *Curry*, 681 F.2d at 411-13; *United States v. Tarnopol*, 561 F.2d 466 (3d Cir. 1977).

> besides *Parr* — showing that *Parr* is not some legal sport that we are free to ignore because the other courts of appeals have ignored it. See *United States* v. *Curry*, 681 F.2d 406, 412 (5th Cir. 1982); *United States* v. *Boyd*, 606 F.2d 792, 794 (8th Cir. 1979) (alternative holding); *cf. United States* v. *Brown*, 540 F.2d 364, 377 (8th Cir. 1976).[121]

By permitting incidental mailings and wirings to substitute for the statutory requirements, the effect of the lower courts' opinions is not only to trivialize the sole basis for federal criminal jurisdiction over what is traditionally state-regulated activity, but also to trivialize the sole overt conduct required under the mail fraud and wire fraud schema. When coupled with the elimination of the other elements, as detailed above, the result is to make mail fraud and wire fraud inchoate crimes, in derogation of the fundamental principle that criminal law may not punish intent alone.[122]

On every score, then, this decision marks the furthest extension to date of the recent "limitless" expansion of the mail and wire fraud statutes. It is time for this Court to set reasonable limits by construing the statute as its own plain language, legislative history and manifest purpose dictate.

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121. *Green*, 786 F.2d at 256–58 (Posner, J., dissenting). The majority in *Green* similarly believed that *Parr* "may require proof that [the predicate] mailings were used with specific intent to defraud the recipients of the mail," but found that such proof had been adduced in *Green*. *Id.* at 250. No such proof was adduced here, however; nor could it be.

122. *The Metastasis of Mail Fraud*, *supra* note 58, at 10–13; *Rakoff*, *supra* note 94, at 775.

CONCLUSION

For the above reasons, the judgment of the Court of Appeals for the Second Circuit should be reversed with instructions to dismiss the indictment.

Dated: February 28, 1987

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In the Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, AND R. FOSTER WINANS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Whether petitioners' trading in securities on confidential, market-affecting information that had been misappropriated in breach of a duty of trust and confidence violated the mail and wire fraud statutes, 18 U.S.C. 1341 and 1343.

2. Whether petitioners' trading in securities on this misappropriated information violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

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In the Supreme Court of the United States

OCTOBER TERM, 1986

No. 86-422

DAVID CARPENTER, KENNETH P. FELIS, AND R. FOSTER WINANS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-29a) is reported at 701 F.2d 1024. The opinion of the district court (Pet. App. 33a-73a) is reported at 612 F. Supp. 827.

JURISDICTION

The judgment of the court of appeals was entered on May 27, 1986. Petitions for rehearing were denied on July 17, 1986. The petition for a writ of certiorari was filed on September 15, 1986, and was granted on December 15, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The texts of 15 U.S.C. 78j(b), 18 U.S.C. 371, 1341 and 1343, and 17 C.F.R. 240.10b-5, are set out in an appendix to this brief.

STATEMENT

Petitioners engaged in a scheme to trade in securities on market-affecting information that was the property of The Wall Street Journal. Petitioner Winans, a writer for the Journal, misappropriated confidential

information about forthcoming Journal articles that were expected to—and did—affect the prices of securities discussed in the articles; Winans, petitioner Felis, a stockbroker, and petitioner Carpenter used that information to buy and sell securities before publication of the articles. After a bench trial in the United States District Court for the Southern District of New York, Felis and Winans were convicted of conspiracy to commit fraud and to obstruct justice, in violation of 18 U.S.C. 371; they were also convicted, together with Carpenter, of securities fraud, in violation of 15 U.S.C. 78j(b) and 78ff, 17 C.F.R. 240.10b-5, and 18 U.S.C. 2; mail fraud, in violation of 18 U.S.C. 1341; and wire fraud, in violation of 18 US.C. 1343.

1. a. Petitioner Winans was hired by the Dow Jones News Service in March 1981. In the summer of 1982, Winans became one of the two full-time writers responsible for The Wall Street Journal's "Heard on the Street" column (*Heard* column). Pet. App. 35a. This feature, which was regarded by Journal editors as "one of the most important" and "sensitive" of the newspaper's columns (C.A. App. A118), was characterized by the district court as "a daily market gossip feature, which highlights a stock or group of stocks and analyzes notable volumes of trading or price movements occurring in the

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[1] Carpenter was sentenced to concurrent terms of three years' probation and to concurrent $1,000 fines on six counts of securities fraud, three counts of mail fraud, and three counts of wire fraud. Winans was sentenced to concurrent terms of 18 months' imprisonment on one count of conspiracy, five counts of mail fraud, and five counts of wire fraud; he was also assessed concurrent $5,000 fines on the conspiracy count and on each of five counts of securities fraud, as well as concurrent $1,000 fines on five counts of mail fraud and five counts of wire fraud, and was placed on five years' probation. Felis was sentenced to concurrent six month sentences on one conspiracy count and on five counts each of securities, mail, and wire fraud; he was also fined a total of $25,000 (specifically, fines of $10,000 on the conspiracy count, $5,000 on one count of securities fraud, and $1,000 on each of five counts of mail and wire fraud), and was placed on five years' probation.

market" (Pet. App. 35a). The *Heard* column "also takes a point of view with respect to investment in the stocks that it reviews" (*ibid.*). Both courts below found that the column has a predictable—and at times dramatic—short-term effect on the prices of the securities it discusses (*id.* at 19a n.9, 35a-36a). Winans and the other petitioners understood the column to have such an impact on the market (*id.* at 36a).

b. When Winans was hired by the Journal he was informed of the conflict of interest policy maintained by Dow Jones & Co., the Journal's publisher. Compliance with that policy (see J.A. 39-43), which has been promulgated to forestall employee actions "detrimental to the best interests of Dow Jones" (*id.* at 39), was labelled "essential" to avoid "the tremendous embarrassment and damage to the Company's reputation that could come about through [an employee's] lapse in judgment" (*id.* at 41; see *id.* at 43). To this end, the policy flatly prohibited Journal employees from disclosing information about the subject or publication date of forthcoming articles, and from trading securities in anticipation of the appearance of those articles. The policy stated:

> First and foremost, all material gleaned by you in the course of your work for Dow Jones is deemed to be strictly the Company's property. This includes not only the fruits of your own and your colleagues' work, but also information on plans for running items and articles on particular companies and industries and advertising schedules in future issues. Such material must never be disclosed to anyone outside the Company, including friends and relatives.

J.A. 41-42; see *id.* at 40. The policy went on to provide that "[n]o employee with knowledge of a forthcoming article, item or advertisement concerning a company or industry should, prior to the publication of such article, item or advertisement, invest in that company or companies in that industry;" employees were instead directed to avoid dealing in the securities of the company involved for two full trading days, "until the general public has

an opportunity to read and digest the information" (*id.* at 42).[2] Because compliance with these rules was understood to be critical to the preservation of Dow Jones' reputation, the statement indicated that "any slip in judgment in * * * [areas] covered in this policy statement [is] serious enough to warrant dismissal" (*id.* at 41).

During Winans' tenure at the Journal, the newspaper took other steps as well to emphasize the importance of, and to insure compliance with, the Dow Jones policy. At least two Journal editors personally reminded Winans early in his employment "of the confidential and sensitive nature of the *Heard* column" and emphasized "the importance of not investing in stocks the writer is covering." These editors subsequently gave Winans "follow-up reminders about the confidentiality of the column." Pet. App. 36a. In February 1984, the Journal's managing editor and New York bureau manager issued a directive to all employees reiterating that "[w]e don't ever tell anyone outside the paper when or if a story is going to run or what it is going to say. Ever" (C.A. App. A108). The district court found that "Winans had actual knowledge of the policy with respect to maintaining confidentiality of the column," "knew that part of his job responsibilities were to keep the subject matter and publication date of the column secret," and "knew that he was supposed to tell his editors if he heard that word was out about a column's topic" (Pet. App. 37a). Winans also knew that he would be fired if he was caught trading in the stock of companies mentioned in

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[2] The policy also indicated that employees were "expected" to "avoid any action, no matter how well-intentioned, that could provide grounds even for suspicion" that they "made financial gains by acting on the basis of 'inside' information obtained through a position on our staff, before it was available to the general public. Such information includes * * * our plans for running stories [and] items that may affect price movements * * *." Employees were also directed to avoid actions that might give rise to a suspicion "that the writing of a news story or item * * * was influenced by a desire to affect the stock's prices." J.A. 40-41.

the *Heard* column or disclosing information about forthcoming columns (*ibid.*).[3]

2. a. In October 1983 Winans entered into a scheme with two stockbrokers at Kidder, Peabody & Co. (Kidder), petitioner Felis and Peter Brant, to trade on his knowledge of forthcoming *Heard* columns. The three agreed that Winans would leak information to the brokers about "the timing, subject and tenor" of soon-to-be-published columns. Armed with this knowledge—and their awareness of the *Heard* column's market impact—the brokers would then buy or sell the securities of the companies to be discussed in the column. The profits would be split among the conspirators. Pet. App. 40a.

Over the next five months, Winans leaked information about approximately 27 *Heard* columns, including columns that he had written and columns written by other Journal reporters.[4] When the topic was set for the fol-

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[3] At trial, Winans denied knowledge of the Journal's policy and testified that he was not informed of the confidentiality of the *Heard* column by his editors (see Pet. App. 36a). The district court, however, specifically "accept[ed] the testimony" of Winans' editors to the contrary, and found "incredible Winans[']' denial that he ever received the conflicts of interest policy statements" (*id.* at 37a).

[4] Both Brant and Winans testified that it was part of their original scheme "that the arrangement would not affect the journalistic purity" of Winans' writing (Pet. App. 40a). The district court, however, noted Winans' testimony before the Securities and Exchange Commission that the "promise of a big distribution of profits" from Brant "was 'an inducement' and a factor in his choosing" to write about a certain stock. While Winans later testified that he in fact exercised independent journalistic judgment in deciding to write the column in question, the district judge did "not accept [Winans'] rejection of his SEC testimony; rather, [the judge] accept[ed] it as evidence of Winans' criminal intent." *Id.* at 45a. While the court found that several others of Winans' columns appeared to be unaffected by the conspiracy, it noted "the difficulty of maintaining a stance of journalistic purity when the reporter is engaged in a decidedly unpure venture" (*id.* at 44a (footnote omitted)). In any event, the court concluded that "[m]aintaining the journalistic purity of the column was actually consistent with the goals of the conspirators" because "a particu-

lowing day's column, Winans would call Brant or Felis with that information. As the district court explained, "[d]epending on the positive or negative tone of the article, stock was either bought or sold short, and call or put options were either bought or sold. Most often, the transactions were closed on the same day as an article's publication, thereby maximizing its impact." Pet. App. 42a. Winans also used his knowledge of forthcoming *Heard* columns to complete six trades for the account of his friend, petitioner Carpenter, who "was aware that these purchases and sales were connected with the appearance of articles in the Journal" (*id.* at 45a).[5] In all, the scheme netted its participants profits of approximately $690,000 (*id.* at 42a).

b. During the course of the scheme, petitioners adopted elaborate strategems to avoid detection by the Journal or public authorities. Winans objected to meeting with Felis or Brant in places where he might be seen by Journal employees or Wall Street acquaintances; he telephoned the two brokers from empty Journal offices or outside pay phones and frequently used a false name when identifying himself to Brant's secretary (Pet. App. 7a, 42a, 44a). Felis and Brant in turn paid Winans his share of the trading profits by checks made payable to Carpenter. To support a cover story that those checks represented payments for decorating services, Felis wrote the word "drapes" on a $10,000 check, and Carpenter subsequently provided Brant and Felis with false invoices for decorating services. *Id.* at 7a, 40a, 43a, 47a-49a.

Petitioners and Brant continued trading in securities even after their activities had aroused suspicion. When questioned by Kidder's Regional Manager in November

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larly compelling column or a fresh investment thesis would have a significant impact on the price of the featured stock" (*id.* at 44a n.4).

[5] Carpenter, a former Journal news clerk, was generally aware of the Dow Jones policy (Pet. App. 37a-38a). In addition to the profits he obtained from the trading in his account, Carpenter acted as a messenger between the conspirators (*id.* at 5a-6a).

1983 about a correlation between their trading and the *Heard* columns, Felis and Brant lied about the source of their information. After being told to stop their trading, they liquidated Felis's existing account but opened a Swiss bank account in the name of a Costa Rican shell corporation through which they continued to trade on Winans' information. Pet. App. 7a, 46a. As investigations into their activities continued, Winans, Felis and Brant repeatedly lied to the Securities and Exchange Commission (SEC), the Journal, and Kidder about the nature both of their trading and of their relationships with one another (*id.* at 7a, 47a-48a). Petitioners and Brant also made efforts—ultimately unsuccessful—to coordinate their deceptive stories (*id.* at 48a-49a).

3. Petitioners were convicted following a 20-day bench trial. In finding petitioners guilty of securities fraud, the district court explained that " 'one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) [of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b)] and Rule 10b-5 [17 C.F.R. 240-.10b-5]' " (Pet. App. 53a (citation omitted)). The court noted that this "misappropriation theory" of securities fraud finds support in the concurring and dissenting opinions in *Chiarella* v. *United States*, 445 U.S. 222 (1980), and is firmly rooted in Second Circuit precedent (Pet. App. 52a-55a). In this case, the court added, "Winans knew he was not supposed to leak the timing or contents of his articles or trade on that knowledge. * * * Winans breached the [Dow Jones] policy and he knew he was breaching it" (*id.* at 58a-59a).

The district court also held that petitioners had committed mail and wire fraud, explaining that Winans' breach of duty and failure to notify the Journal about leaks of the *Heard* column defrauded his employer. The court noted that "Winans' disclosures can only be seen as an abuse of his employers' confidences since he owed a fiduciary duty to the Wall Street Journal not to disclose the contents of the [*Heard*] column in advance"

(Pet. App. 61a); Winans was "aware[] that he had a duty not to disclose the content and timing of publication of the column as well as a duty to disclose, at the very least, any leaks of the column" (*id.* at 62a). The court also found that the scheme contemplated actual harm to the Journal: petitioners' activities "placed immediately in jeopardy probably [the Journal's] most important asset—its reputation for fairness and integrity" (*id.* at 64a). The court thus found that "[t]he scheme's injurious consequences to the Journal must have been known to Winans" (*ibid.*) and to the other participants (*id.* at 64a-65a). Similarly, the court held that the telexing of articles for printing and the mailing of the Journal to subscribers were "integral part[s] of the scheme to defraud" (*id.* at 66a). And the court found that Winans and Felis acted with specific intent to deceive and defraud the Journal (see *id.* at 68a-69a, 71a-72a).[6]

4. In relevant part, the court of appeals affirmed petitioners' convictions.[7] Addressing the securities law counts, the court found that Winans "breached a duty of confidentiality to his employer by misappropriating from the *Journal* confidential prepublication information" (Pet. App. 10a), an action that "sull[ied] [the Journal's] reputation and thereby defraud[ed] it 'as surely as if [petitioners] took [its] money'" (*id.* at 18a (citation omitted)). This misappropriation, the court continued,

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[6] Petitioners assert that "neither Winans, Brant, nor Felis believed that they were acting illegally" (Pet. Br. 4). The district court, however, expressly found otherwise. It determined that "Felis' conduct throughout demonstrates that he was a willful and knowing participant in what he understood was an unlawful venture" (Pet. App. 71a). The court also found that "Winans and Felis, together with Brant, each had the requisite specific intent to defraud" (*id.* at 72a). The court found that Carpenter aided and abetted the scheme with the awareness "that what Winans was doing was a fraud on the [Journal]" (*ibid.*; see *id.* at 73a).

[7] The court of appeals reversed Winans' conviction on several counts involving trading by Felis that was outside the scope of the conspiracy (Pet. App. 26a-27a).

ran afoul of Section 10(b) and Rule 10b-5, which "broadly proscribe[ ] the conversion by 'insiders' *or others* of material nonpublic information in connection with the purchase or sale of securities" (Pet. App. 11a (emphasis in original)); the court added that application of the misappropriation theory in this context serves generally to forestall fraudulent practices (*id.* at 13a) and furthers "Congress' stated concern for the perception of fairness and integrity in the securities markets" (*id.* at 13a-14a). And "the use of the misappropriated information for the financial benefit of [petitioners] and to the financial detriment of those investors with whom [petitioners] traded," the court held, "supports the conclusion that [petitioners'] fraud was 'in connection with' the purchase or sale of securities under section 10(b) and Rule 10b-5" (*id.* at 18a).

The court of appeals found it unnecessary to "dwell at length on [petitioners'] convictions for violating federal mail and wire fraud statutes" (Pet. App. 23a). The court explained that confidential commercial information "may constitute fraudulently misappropriated 'property' under the mail fraud statute" (*ibid.*), and that petitioners' scheme to misappropriate nonpublic information from the Journal accordingly fell within the scope of 18 U.S.C. 1341 and 1343 (Pet. App. 24a). The court also concluded that the "foreseeability and centrality to the scheme" of the mailings and wirings associated with the publication and distribution of the Journal "were sufficient predicates to allow a conclusion that [petitioners] violated the mail and wire fraud statutes" (*id.* at 25a).[8]

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[8] Judge Miner joined the court's opinion insofar as it upheld petitioners' convictions on the mail and wire fraud counts, but he dissented from the court's holding on securities fraud (Pet. App. 27a-29a). He reasoned that "[n]o confidential securities information imparted by reason of any special relationship was purloined by [petitioners]," concluding that petitioners' "conduct is addressed adequately by statutes establishing the mail and wire fraud offenses of which [petitioners] stand convicted" (*id.* at 28a, 29a).

SUMMARY OF ARGUMENT

A. Petitioner Winans *posed* as a loyal employee of The Wall Street Journal. That deception afforded him continuing access to the Journal's confidential information, which he and the other petitioners used to trade securities. His trading violated his duties to the Journal and knowingly endangered the very asset of the newspaper that made the scheme work—the Journal's reputation for reliability and integrity. Winans' present pose as a newspaperman who happened to traverse the idiosyncratic workrules of a fussy employer is sheer nonsense.

Petitioners' conduct was more than the dishonest and ethically reprehensible action that they concede it to have been: it was a criminal fraud. It was well settled at the time of the enactment of the mail fraud statute in 1872, and it is equally clear today, that deceptive use of a relationship of trust and confidence with the victim, to gain advantage while knowingly harming or risking harm to the victim, is a fraud. Winans plainly had such a relationship with his employer. He fostered and carefully maintained a misimpression, on the part of the Journal, that he was a trustworthy employee and that the *Heard* column was not, to his knowledge, being leaked or misused. Petitioners used this misimpression and Winans' position of trust to gain access to a continuing flow of confidential information; that flow started because Winans made at least implicit representations of loyalty at the outset of his employment, and continued because Winans failed both to disabuse the Journal of its mistaken belief in the continuing validity of those representations and to comply with his specific duty to disclose leaks of the *Heard* column. And as petitioners well knew, their scheme to make money both relied on, and posed a substantial risk of harm to, an extremely valuable (albeit intangible) asset of the Journal, its reputation for reliability and integrity.

This scheme depended for its success on the publication of the *Heard* column, which required use of the mails

and interstate wires. Winans concededly caused use of the mails and wires when he delivered *Heard* columns to his editors with the expectation and intention that they be wired to the Journal's printing plant and mailed to the Journal's subscribers. Petitioners' contention that these transmissions would have occurred in the same form in the absence of the scheme is both unwarranted by the record and irrelevant: Winans caused the mailing and wiring of his columns with the pre-existing intention of using these particular columns (once transported) to commit a fraud. The scheme therefore violated 18 U.S.C. 1341 and 1343.

B. 1. Petitioners used their fraudulently misappropriated information to "'reap instant no-risk profits in the stock market'" (Pet. App. 19a-20a (citation omitted)). As four Justices of this Court (in *Chiarella* v. *United States*, 445 U.S. 222 (1980)), lower courts, and committees of Congress had concluded even prior to the events of this case, trading on misappropriated information violates Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

Petitioners' trading on fraudulently misappropriated information clearly falls within the broad language of the statute and rule: Section 10(b) makes it unlawful for "any" person, "directly or indirectly," to use "any" deceptive device in connection with the purchase or sale of "any" security, in violation of SEC rules; Rule 10b-5 proscribes "any" fraud upon "any" person in connection with the purchase or sale of "any" security. Here, petitioners committed a deliberate fraud upon the Journal, and the sole purpose of the fraud was to profit in securities trading. Beyond fidelity to the language, the prohibition of petitioners' trading on misappropriated information also serves both the Exchange Act's central purpose of "insur[ing] the maintenance of fair and honest markets" (15 U.S.C. 78b), and Section 10(b)'s particular aim of eliminating from securities trading all "manipulative and deceptive practices which have been demonstrated to

fulfill no useful function" (S. Rep. 792, 73d Cong., 2d Sess. 6 (1934)).

2. At certain points in their argument, petitioners seem to attack the misappropriation theory, suggesting that Section 10(b) proscribes only trading by "insiders" of the corporation whose stock is traded (who owe fiduciary duties to the persons on the other side of the transactions). But no decision of this or any other court has ever endorsed such a limitation on the scope of Section 10(b) or Rule 10b-5, which would be contrary to the language of the statute and rule. Such a limitation also would leave a large and illogical gap in the enforcement of the securities laws: it would permit persons who trade on information that is misappropriated from a tender offer bidder, from an investment banker advising a client about a possible investment in the subject company, or indeed from any party other than the company whose shares are traded, to go largely unpunished. Petitioners' related suggestion that in a public enforcement action the government must allege and prove injury to specified persons on the other side of the transactions has no basis in language, precedent, or logic.

At other points in their argument, petitioners appear to acknowledge that trading in the stock of one company on information fraudulently misappropriated from another is unlawful, but only (they say) if the third-party owner of the information is itself a "market participant," such as a takeover bidder. This limitation also finds no basis in language, precedent, or logic. While the misappropriation of information from a potential buyer or seller of securities may cause that person particular injury in connection with *its* purchases or sales of securities, the fundamental evil of trading on misappropriated information is that it "is unfair and inconsistent with the investing public's legitimate expectation of honest and fair securities markets where all participants play by the same rules." H.R. 98-355, 98th Cong., 1st Sess. 5 (1983). The use of such devices will drive investors out of the market, threatening both "[c]apital formation and our nation's economic growth and stabil-

ity" (*id.* at 2). Trading on misappropriated information inflicts a wound on the market and all who participate in it.

Petitioners' suggestion that they should not be convicted for trading that would have been lawful for Dow Jones is an attempt to throw sand in the Court's eyes. First, it is by no means clear, as the court of appeals noted, that a financial newspaper could make prepublication trades without violating Section 10(b) (albeit under a different theory than the one involved in this case). Second, there plainly are situations (such as pre-announcement purchases by a takeover bidder) where an owner of information is permitted, consistently with the language and philosophy of the securities laws, to trade on information that may not be misappropriated and used by an employee. Third, conversely, there is nothing anomalous about relying on the integrity and self-interest of the owner of the information (reflected in this instance by the very rules petitioners broke) to deter trading that is barred to a thief by a criminal statute such as Section 10(b).

ARGUMENT

PETITIONERS' MISAPPROPRIATION AND USE OF CONFIDENTIAL INFORMATION VIOLATED FEDERAL LAW

Petitioners' scheme was a classic fraud. Winans posed as a loyal employee of The Wall Street Journal, a deception that afforded him continuing access to confidential information; petitioners used that information to buy and sell securities in a manner that they knew endangered interests of the Journal. This sort of deceptive use of a position of trust is "as old as falsehood" (*Weiss* v. *United States*, 122 F.2d 675, 681 (5th Cir. 1941)), and as fraudulent. Because petitioners' scheme depended for its success on the use of the mails and interstate wires, it violated 18 U.S.C. 1341 and 1343. And because the purpose of the scheme was to " 'reap instant no-risk profits in the stock market' " (Pet. App. 19a-20a (citation omitted)) by trading with investors who "would

not have purchased or sold, at least at the transaction prices, had they had the benefit of that [improperly acquired] information" (*id.* at 18a), it violated the anti-fraud provisions of the federal securities laws as well.

A. An Employee Violates The Federal Mail And Wire Fraud Statutes When, In A Scheme That Requires Use Of The Mails And Interstate Wires, He Fosters And Maintains A Misimpression That Affords Him Access To His Employer's Confidential Information, Which He Uses To His Benefit And To The Employer's Detriment

The federal mail and wire fraud statutes, which in relevant part are identical, make it illegal to use the mails or interstate wires "for the purpose" of furthering "any scheme or artifice to defraud." 18 U.S.C. 1341, 1343.[9] It is common ground that the crimes defined by these statutes have two elements: a scheme to defraud (which contemplates some sort of harm to the victim), and a mailing or wiring. Both of those elements are abundantly present here. Petitioners' case is unusual, if at all, only in "the subtlety of the[ir] scheme" (*United States* v. *Bush*, 522 F.2d 641, 646 (7th Cir. 1975), cert. denied, 424 U.S. 977 (1976)).

1. *Scheme or artifice to defraud.* a. Sections 1341 and 1343 are written in broad terms. They apply to "*any* scheme or artifice to defraud," language that contains no explicit limits and that was drafted in a "sufficiently general" fashion to be applicable against novel or unanticipated forms of fraudulent conduct. *United States* v. *Maze*, 414 U.S. 395, 399 n.4 (1974). Indeed, Congress chose not to write an express definition of the term "fraud," and the term has resisted judicial definition; the courts have recognized, in Judge Holmes' famous phrase, that fraud is "as versable as human ingenuity" (*Weiss*, 122 F.2d at 681). But the concept of fraud nevertheless

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[9] As petitioners note (Pet. Br. 30 n.60), the mail and wire fraud statutes should be given a parallel interpretation. See, *e.g.*, *United States* v. *Lemire*, 720 F.2d 1327, 1335 (D.C. Cir. 1983) (citing cases), cert. denied, 467 U.S. 1226 (1984). References in this brief to either statute accordingly apply to both, unless differences are indicated.

has defined boundaries: it draws its content from the background of the mail and wire fraud statutes, and from a century of case law.

As the Court explained over 60 years ago, the hallmark of fraud is "trick, deceit, chicane or overreaching." *Fasulo* v. *United States*, 272 U.S. 620, 627 (1926). Certainly, as petitioners note (Pet. Br. 34), an explicit, affirmative misrepresentation about particular facts falls within this category of conduct. But so does a defendant's deliberately deceptive use of what the courts have called a relationship of "trust and confidence." When a defendant enters into such a relationship with the victim, feigns continuing loyalty, conceals his disloyal actions in violation of established disclosure obligations, and *uses* the resulting misimpression to his benefit and to the victim's detriment—for example, by obtaining continuing access to the victim's property or information, which he then misappropriates—the defendant has committed fraud. In such a case the defendant is able to benefit himself only because the victim trusted him, and because he allowed the victim to act under a misimpression about the nature of their relationship that he fostered and was under a duty to correct. These are the essential characteristics of a fraudulent breach of trust. See generally *Chiarella* v. *United States*, 445 U.S. 222, 227-228, 232 (1980); *id.* at 247 (Blackmun, J., dissenting); *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 186, 193-194 (1963); Restatement (Second) of Torts § 551(2)(a) (1977); Keeton, *Fraud—Concealment and Non-Disclosure*, 15 Tex. L. Rev. 1, 11, 12-13 (1936); James & Gray, *Misrepresentation—Part II*, 37 Md. L. Rev. 488, 525 (1978) (cited in *Chiarella*, 445 U.S. at 228 n.9).[10] See also au-

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[10] While petitioners acknowledge that this sort of conduct may constitute a "constructive fraud" (Pet. Br. 33-34 & n.74), they argue that a breach of duty, when unaccompanied by an express misrepresentation, cannot give rise to criminal liability. But that proposition has been flatly rejected by this Court under the anti-fraud provisions of the securities laws. See *Chiarella*, 445 U.S. at 232. Indeed, under Sections 1341 and 1343, the courts of appeals have uniformly held that criminal liability may be imposed when

thorities cited at pages 20-21 note 16, 22, 24-25 note 23, *infra*.

The courts have long recognized that persons who assume positions of trust, undertaking to work loyally on another's behalf, commit "a major type of dishonesty" (*Post* v. *United States*, 407 F.2d 319, 329 (D.C. Cir. 1968), cert. denied, 393 U.S. 1092 (1969)) when they "obtain[] and then betray[] the confidence of another." *Shushan* v. *United States*, 117 F.2d 110, 115 (5th Cir.), cert. denied, 313 U.S. 574 (1941). *See United States* v. *Lemire*, 720 F.2d 1327, 1335 (D.C. Cir. 1983), cert. denied, 467 U.S. 1226 (1984).[11] The victim is, after all, as entitled to rely on the loyalty of those who hold themselves out as trustworthy as on arms' length representations made in the course of business. See 2 F. Harper, F. James & O. Gray, *The Law of Torts*, § 7.14, at 473-474 (2d ed. 1986). And one who enters a relationship of trust on the understanding that he will act in accord with certain rules, who continues in that position after delib-

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the defendant breaches a duty of trust with the intention of taking advantage of the principal, and when concealment and an intent to deceive are elements of the scheme. The crucial question is not whether the scheme involved an affirmative misstatement rather than a breach of duty, but whether the defendant intended to take advantage of—to defraud—the other party to the relationship. See *United States* v. *Ballard*, 663 F.2d 534, 541 n.17 (1981), modified on reh'g, 680 F.2d 352 (5th Cir. 1982); *United States* v. *Von Barta*, 635 F.2d 999, 1005 n.14 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981); *Epstein* v. *United States*, 174 F.2d 754, 766 (6th Cir. 1949). See generally Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 Am. Crim. L. Rev. 117, 122-123 n.30 (1981); Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1252-1257 (1983). See also note 21, *infra*.

[11] As Professor Coffee notes in an article that is selectively quoted by petitioners (Pet. Br. 37), "a knowing fiduciary breach may be as egregious, injurious and deliberately fraudulent as the garden variety embezzlement." *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 Am. Crim. L. Rev. 117, 149 (1981).

erately breaking those rules and failing to inform the other party of this change in the basis of their relationship, and who *uses* his position of trust to benefit himself at the other's expense, has indeed engaged in "trick, deceit, chicane, or overreaching." [12] What constitutes deception turns on context; if the victim allows the defendant to manage his business or obtain access to his property on a certain set of shared understandings, the defendant's failure to disclose his rejection of those understandings is recognized by the courts to be as fundamentally deceptive as an outright lie.

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[12] As one commentator has noted, "the fiduciary's failure to disclose material facts to a person who is entitled to rely on him is a tacit representation of the nonexistence of those facts." Similarly, one who misappropriates something with which he is entrusted violates his "implicit representation that he would not convert the thing to his own use." Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101, 116, 119 (1984). This sort of fraud is often put in terms of breach of a duty of disclosure; one party to a relationship of trust is entitled to rely on the loyalty of the other party unless the second party reveals an adverse interest. See generally Restatement (Second) of Agency §§ 389, 390, 395 comment c (1958). In such a situation, as Professor Keeton has explained, "the operative effect of nondisclosure, where the courts have imposed a duty to speak, is the same as if there had been a misrepresentation." Keeton, *supra*, 15 Tex. L. Rev. at 1-2. This duty to disclose need not be expressly imposed by the principal, as petitioners seem to assert (Pet. Br. 33, 34) (although the Journal did in fact expressly impose a disclosure obligation on Winans, as we explain at page 26, *infra*). It arises from the relationship of trust; a party to such a relationship is obligated to communicate to the other party "matters known to him that the other *is entitled* to know because of a fiduciary or other similar relation of trust and confidence between them." Restatement (Second) of Torts § 551(2)(a) (emphasis added). Cf. *Dirks* v. *SEC*, 463 U.S. 646, 655 n.14 (1983). While petitioners argue that it would have been anomalous to expect Winans to disclose his activities to the Journal, that fact demonstrates only that Winans' conduct was utterly inconsistent with the Journal's interests. See also Restatement (Second) of Torts §§ 529, 551(2)(b); Keeton, *supra*, 45 Tex. L. Rev. at 1, 6, 27; 2 F. Harper, F. James & O. Gray, *supra*, § 7.14, at 472, 474.

b. Contrary to petitioners' contention (Pet. Br. 33-36), a relationship of trust, in which concealment and nondisclosure of a breach of duty may disadvantage the victim, does not depend on the existence of a formally denominated "fiduciary" duty: it has long been understood that "[t]he confidential relationship is not at all confined to any specific association of the parties to it." *Appeal of Darlington*, 147 Pa. 624, 629-630, 23 A. 1046, 1047 (1892). Such associations include not only formal trust relationships, but also those of "principal and agent, master and servant, * * * and, generally, all persons who are associated by any relation of trust and confidence" (*ibid.*). See Restatement (Second) of Torts § 551 comment e; Restatement (Second) of Agency §§ 381, 389 (1958); 2 F. Harper, F. James & O. Gray, *supra*, § 7.14, at 473-474 & n.11.

As the common law recognizes, the relationship of employer and employee has these characteristics of trust and confidence. An employee has a duty not only to work loyally for the benefit of his employer, but also to disclose matters relevant to his employment and to refrain from acting in a manner adverse to his employer's interests absent full disclosure to the employer. See Restatement (Second) of Agency §§ 381, 389, 390 and comment d, 395.[13] It follows that an employee, no less than

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[13] Agents generally are "subject to a duty" to give to their principals "information which is relevant to the affairs entrusted to [them] and which, as the agent[s] ha[ve] notice, the principal[s] would desire to have." Restatement (Second) of Agency § 381. An agent must disclose such information "although not specifically instructed to do so. The duty exists if the agent has notice of facts which, in view of his relations with the principal, he should know may affect the desires of the principal as to his own conduct." *Id.* § 381 comment a. In addition, the common law rule is that "an agent is subject to a duty to the principal not to use or communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency * * * to the injury of the principal, on his own account or on behalf of another." *Id.* § 395. This rule precludes the use by the agent of confidential information "for any purpose likely to cause his principal harm * * *. Thus, an agent who is told by the prin-

anyone else in a relationship of confidence grounded in mutual understandings, engages in the special form of dishonesty and deception that accompanies a breach of trust when he "hold[s] himself out to be a loyal employee, acting in [the employer's] best interests, but actually not giving his honest and faithful services, to [the employer's] real detriment." *United States* v. *Bryza*, 522 F.2d 414, 422 (7th Cir. 1975), cert. denied, 426 U.S. 912 (1976). Such an employee, "in using [his] relationship [of trust and confidence with his employer] for the express purpose of carrying out a scheme to obtain his employer's confidential information and other property * * * would be guilty of deliberately producing a false impression on his employer in order to cheat him. Such conduct would constitute a positive fraud." *United States* v. *Procter & Gamble Co.*, 47 F. Supp. 676, 678 (D. Mass. 1942).[14]

The courts of appeals have thus uniformly held, in Judge Friendly's words, that "a scheme to use a private fiduciary position to obtain direct pecuniary gain is within the mail fraud statute," at least where that scheme contemplates some sort of harm to the principal. *United States* v. *Dixon*, 536 F.2d 1388, 1399-1400 (2d Cir. 1976). Without dissent on the point,[15] the courts of

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cipal of his plans * * * is not privileged to use such information at his principal's expense." *Id.* § 395 comment a.

[14] Use of a continuing misimpression to gain access to property or information is even more obviously a crime of "trick, deceit, chicane, or overreaching" than offenses such as embezzlement or misappropriation, which are understood to be " 'garden variety' type[s] of fraud" (*Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 11 n.7 (1971)); embezzlement need involve no more than a betrayal of confidence by the defendant *after* he has been entrusted with the victim's property. See *Grin* v. *Shine*, 187 U.S. 181, 189-190 (1902) ("it is impossible for a person to embezzle the money of another without committing a fraud upon him"); *Parr* v. *United States*, 363 U.S. 370, 385 (1960). See generally 2 W. LaFave & A. Scott, *Substantive Criminal Law* § 8.6 (1986).

[15] Petitioners have cited a number of opinions (primarily dissents and separate concurrences) and law review articles for the

appeals have concluded, as the District of Columbia Circuit explained in a thoughtful opinion, that "[s]o long as the jury finds [that the employee's] non-disclosure furthers a scheme to abuse the trust of the employer in a manner that makes an identifiable harm to him, apart from the breach itself, reasonably foreseeable, it may convict the employee of fraud." *Lemire*, 720 F.2d at 1337.[16] And the courts of appeals have reached what has

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general proposition that "expansion of the mail and wire fraud statutes have been severely criticized" (Pet. Br. 28; see *id.* at 28 n.56, 29 n.57, 29-30 n.58). Whatever the validity of that criticism, however, it has been leveled almost entirely at aspects of mail and wire fraud doctrine that are not at issue in this case. See, *e.g.*, *United States* v. *Weiss*, 752 F.2d 777, 791 (2d Cir.) (Newman, J., dissenting) (addressing specificity of the indictment), cert. denied, No. 84-1645 (Nov. 4, 1985); *United States* v. *Margiotta*, 688 F.2d 108, 140 (2d Cir. 1982) (Winter, J., dissenting) (addressing application to political party officials), cert. denied, 461 U.S. 913 (1983); *United States* v. *Craig*, 573 F.2d 455, 497 (7th Cir. 1977) (Swygert, J., dissenting) (addressing use of mails on the facts of that case), cert. denied, 439 U.S. 820 (1978); Jeffries, *Legality, Vagueness, and the Construction of Penal Statutes*, 71 Va. L. Rev. 189, 237-242 (1985) (addressing application to political party officials). And *none* of the decisions cited by petitioners has taken issue with the fundamental (and here dispositive) proposition that an employee may commit a fraud by obtaining a benefit, at his employer's expense, by abusing the employer's misplaced trust. While a number of the opinions and articles cited by petitioners suggest that the deprivation of an employee's loyal services, standing alone, cannot support a prosecution under Sections 1341 and 1343, that conclusion, even if correct, is simply inapposite in this case: the government charged, and both courts below found, that the victim here suffered *other* substantial and expectable injuries. See pages 28-32, *infra*.

[16] See, *e.g.*, *United States* v. *Conner*, 752 F.2d 566, 572 (11th Cir.), cert. denied, 474 U.S. 821 (1985); *United States* v. *Alexander*, 741 F.2d 962 (7th Cir. 1984); *United States* v. *Siegel*, 717 F.2d 9, 13-14 (2d Cir. 1983); *United States* v. *Feldman*, 711 F.2d 758, 763 (7th Cir.), cert. denied, 464 U.S. 939 (1983); *United States* v. *Curry*, 681 F.2d 406, 409, 411 (5th Cir. 1982); *United States* v. *Ballard*, 663 F.2d 534, 540 (1981) (dictum), modified on reh'g, 680 F.2d 352 (5th Cir. 1982); *United States* v. *Bronston*, 650 F.2d 920, 926 (2d Cir. 1981), cert. denied, 456 U.S. 915 (1982); *United States* v. *Shamy*, 656 F.2d 951, 957 (4th Cir.

been called a "judicial consensus" that the duty giving rise to the fraud may stem from an employment relationship. *Id.* at 1335-1336.[17]

c. The concept of fraud is in fact substantially broader than necessary to sustain the conviction here, and petitioners are simply wrong in arguing (see Pet. Br. 31, 36) that there is some novelty in treating a breach of trust or fiduciary duty as either fraudulent or criminal. At the time of the enactment of the original predecessor to Section 1341 in 1872, a breach of duty by one with whom the victim shared "any relation of trust and confidence" (*Darlington*, 147 Pa. at 629-630, 23 A. at 1047) was well understood to be fraudulent.[18] This

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1981), cert. denied, 455 U.S. 939 (1982); *United States* v. *Von Barta*, 635 F.2d at 1007; *United States* v. *Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), cert. denied, 447 U.S. 928 (1980); *United States* v. *Reece*, 614 F.2d 1259, 1261 (10th Cir. 1980); *United States* v. *Bryza*, 522 F.2d 414, 422 (7th Cir. 1975), cert. denied, 426 U.S. 912 (1976); *Post*, 407 F.2d at 329. Cf. *Abbott* v. *United States*, 239 F.2d 310, 314 (5th Cir. 1956). In addition, the courts of appeals have uniformly held that a public official commits fraud when he corruptly breaches his duties to the public. See, *e.g.*, *United States* v. *Silvano*, 812 F.2d 754, 758-759 (1st Cir. 1987); *United States* v. *Lovett*, 811 F.2d 979 (7th Cir. 1987); *United States* v. *Margiotta*, 688 F.2d 108, 120 (2d Cir. 1982), cert. denied, 461 U.S. 913 (1983); *United States* v. *Mandel*, 591 F.2d 1347, 1357-1364, aff'd in relevant part, 602 F.2d 653 (4th Cir. 1979) (en banc), cert. denied, 445 U.S. 961 (1980); *United States* v. *Isaacs*, 493 F.2d 1124, 1149 (7th Cir.), cert. denied, 417 U.S. 976 (1974); *United States* v. *States*, 488 F.2d 761, 763-767 (8th Cir. 1973), cert. denied, 417 U.S. 909 (1974); *United States* v. *Edwards*, 458 F.2d 875, 880-881 (5th Cir.), cert. denied, 409 U.S. 891 (1972). For earlier cases involving both public and private fiduciaries, see page 26 and note 23, *infra*.

[17] See, *e.g.*, *United States* v. *Conner*, 752 F.2d 566, 572 (11th Cir. 1985), cert. denied, 474 U.S. 821 (1985); *United States* v. *Ballard*, 663 F.2d at 541; *United States* v. *Von Barta*, 635 F.2d at 1007; *United States* v. *Reece*, 614 F.2d at 1261; *United States* v. *Bryza*, 522 F.2d at 422.

[18] The relation of principal and agent in particular was understood at the time to be one of trust and confidence. See, *e.g.*, M. Bigelow, *The Law of Fraud* 222 (1877); T. Cooley, *A Treatise*

Court regularly noted in the nineteenth century that self-dealing agents or trustees "commit[ted] * * * fraud upon" their principals. *Wardell* v. *Railroad Co.*, 103 U.S. 651, 657 (1880). See, *e.g.*, *Michoud* v. *Girod*, 45 U.S. (4 How.) 503, 553 (1846). Indeed, courts of equity in the nineteenth century recognized as frauds " 'all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another.' " *Moore* v. *Crawford*, 130 U.S. 122, 128 (1889) (quoting 1 J. Story, *Equity Jurisprudence* § 187). See *Capital Gains Research Bureau*, 375 U.S. at 143-144; *United States* v. *Carter*, 217 U.S. 286, 306 (1910).[19]

Congress plainly had these general notions of fraud in mind when it enacted Section 1341. While the legislative history of the statute is not illuminating,[20] Congress's choice of language expressed an extraordinarily broad purpose. The statute's "any scheme or artifice to

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on the Law of Torts 595 (2d ed. 1888); F. Tiffany, *Handbook of the Law of Principal and Agent* 415 (1903).

[19] The rationale for this principle was plain: in cases where the interests of a principal and agent are adverse, "[t]he employers are, thus, thrown off their guard; they are led to suppose they have an agent acting solely with a view toward their interest * * * while, in fact, the agent is conferring with himself." 1 J. Hovenden, *A General Treatise on the Principles and Practice by Which the Courts of Equity are Guided as to the Prevention or Remedial Correction of Fraud* 145 (1832).

[20] Virtually the only legislative history of the 1872 legislation—which, like the current version of the mail fraud statute, prohibited "any scheme or artifice to defraud"—is the statement by one of the sponsors that the act was directed at "frauds which are mostly gotten up in large cities * * * by thieves, forgers, and rapscallions generally, for the purposes of deceiving and fleecing the innocent people in the country." Cong. Globe, 41st Cong., 3d Sess. 35 (1870) (remarks of Rep. Farnsworth). Although the statute has since been amended on several occasions, none of the modifications has affected (or has shed light on the meaning of) the "scheme or artifice to defraud" language. See generally Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. 771, 779-780 (1980).

defraud" formula was novel; that phrase's general reference to "fraud"—a term that was understood at the time to encompass breaches of trust—omitted familiar limitations found both in the ancient property offenses such as false pretenses and in the common law civil action of deceit.[21] As a result, this Court and the lower federal courts, from the time of their earliest interpretations of the mail fraud statute, made it clear

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[21] Compare 1 J. Bishop, *Commentaries on the Criminal Law* §§ 565-590 (7th ed. 1882) (setting out technical requirements for property crimes such as embezzlement and false pretenses); 2 W. LaFave & A. Scott, *Substantive Criminal Law* 327-409 (1986) (same); Pearce, *Theft by False Promises*, 101 U. Pa. L. Rev. 967 (1953) (same); T. Cooley, *A Treatise on the Law of Torts* 555-556 (2d ed. 1888) (setting out requirements for common law action of deceit). Indeed, decisions and treatises of the time referred to the common law action for misrepresentation not as "fraud" but as "deceit." See, *e.g.*, J. Bishop, *Commentaries on the Non-Contract Law* 132-144 (1889); T. Cooley, *supra*, at 555-556; 1 E. Jaggard, *Hand-Book of the Law of Torts* 558-602 (1895); F. Pollock, *A Treatise on the Law of Torts* 348-388 (1894). In contrast, the term "fraud," when used alone, signified a range of overreaching conduct, including both misrepresentation and breach of trust. See 1 J. Hovenden, *supra*, at 145-177; M. Bigelow, *The Law of Fraud* (1877); T. Cooley, *supra*, at 554-555, 595-621; 2 F. Hilliard, *The Law of Torts* 74 (1874). See also 1 *Bouvier's Law Dictionary* 530 (1897) ("[t]o defraud is to withhold from another that which is justly due him, or to deprive him of a right by deception and artifice"; W. Anderson, *A Dictionary of Law* 474 (1893); 2 J. Stephen, *A History of the Criminal Law of England* 121 (1883) (hallmark of fraud is "deceit or intention to deceive or in some cases mere secrecy"). Because fiduciary self-dealing was presumed to involve overreaching, such breaches of duty were often labeled "constructive frauds" and were treated as improper even where the trustee acted in good faith. See generally 1 J. Hovenden, *supra*, at 145-177; M. Bigelow, *supra*, at 190-318. Where the fiduciary acted with an intention to take advantage of his position of trust, however, his actions were understood to be not only "constructively" but "actually" improper. See M. Bigelow, *supra*, at lviii (1877) ("In all cases of constructive fraud, there may also be actual fraud."). The term "fraud," when understood to signify a dishonest intent, was seen as "one of the elements of [the] specific tort called Deceit." M. Bigelow, *Elements of the Law of Torts* 16 (7th ed. 1901).

that Section 1341 reaches beyond both the crime of false pretenses and common law misrepresentation. *Durland* v. *United States*, 161 U.S. 306, 313 (1896); *United States* v. *Loring*, 91 F. 881 (N.D. Ill. 1884); *United States* v. *Bernard*, 84 F. 634 (C.C.S.D.N.Y. 1898); *O'Hara* v. *United States*, 129 F. 551 (6th Cir. 1904). See generally Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. 771, 799 (1980); Note, *Survey of the Law of Mail Fraud*, 1975 Ill. L.F. 237-239. Indeed, the Court consistently held that the predecessor to 18 U.S.C. 371, a companion statute to Section 1341 that makes it illegal to conspire to "defraud the United States * * * in any manner," reaches corruption and breach of duty on the part of public officials even in the absence of any affirmative misstatement on their part.[22]

Given this background, it is not surprising that the courts of appeals, from the time of their first encounter with the issue, have held that breaches of duty by employees or other persons in positions of trust and confidence—either private or public—violate the mail fraud statute. Almost 50 years ago, the Second Circuit upheld a prosecution under the predecessor to Section 1341 on the theory that "[u]sing a fiduciary position as a [bondholder] protective committee member to obtain secret profits based upon inside information is not only a breach of trust, but an active fraud on the bondholders." *United States* v. *Buckner*, 108 F.2d 921, 926 (2d Cir.), cert. denied, 309 U.S. 669 (1940). And other courts of

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[22] See *Haas* v. *Henkel*, 216 U.S. 462, 476-477 (1910); *Glasser* v. *United States*, 315 U.S. 60, 66 (1942); Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 Am. Crim. L. Rev. 117, 123 n.32 (1981). Originally enacted in 1867 (Act of Mar. 2, 1867, ch. 169, § 30, 14 Stat. 484), Section 371 was understood even before the passage of Section 1341 to be "more comprehensive" than the common law. *United States* v. *Whalan*, 28 F. Cas. 531, 532 (D. Mass. 1868) (No. 16609).

appeals uniformly came to the same conclusion in the immediately succeeding years.[23]

d. Petitioners' conduct involved a deliberate and deceptive breach of Winans' duty of trust. Winans plainly occupied a position of trust and confidence at the Journal. Winans knew that he had been entrusted with the Journal's most sensitive and confidential information—some of which he was hired to create for the Journal's benefit—and that the Journal considered the information strictly "the Company's property" (J.A. 41-42). He knew that his employer considered it "essential" (*id.* at 41, 43) that he not disclose that information or use it to buy and sell securities on his own account. He was specifically told (*id.* at 41), and was found by the district court to have understood (Pet. App. 37a), that compliance with the Journal's conflict rules was a condition of his continued employment. He was given special and repeated reminders of the importance of confidentiality (*id.* at 36a). The Journal thus plainly expected Winans not to use, and to report any unauthorized use of, its confidential information. And

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[23] *Shushan*, 117 F.2d at 115. See *United States* v. *Groves*, 122 F.2d 87, 90 (2d Cir.), cert. denied, 314 U.S. 670 (1941); *Bradford* v. *United States*, 129 F.2d 274, 275 (5th Cir.), cert. denied, 317 U.S. 683 (1942); *Steiner* v. *United States*, 134 F.2d 931, 933 (5th Cir.), cert. denied, 319 U.S. 774 (1943); *United States* v. *Classic*, 35 F. Supp. 457, 458 (D. La. 1940), aff'd on other grounds, 313 U.S. 299 (1941). See generally *Epstein* v. *United States*, 174 F.2d 754, 766-768 (6th Cir. 1949); *Procter & Gamble Co.*, 47 F. Supp. at 678. These cases have a special significance for the interpretation of the wire fraud statute, Section 1343. That statute, which is obviously modeled on Section 1341, was enacted in 1952. Communications Act Amendments, ch. 879, § 18(a), 66 Stat. 722. While the legislative history of Section 1343 is not extensive (see S. Rep. 44, 82d Cong., 1st Sess. 14 (1951)), Congress passed the wire fraud statute against the background of the series of successful breach of trust prosecutions under Section 1341, including a number of prosecutions involving public officials and prominent private parties. The drafters of Section 1343 can be presumed to have been familiar with this use of Section 1341—which had been repeatedly affirmed by the courts of appeals—and to have endorsed it when they borrowed the language of Section

contrary to petitioners' assertion (Pet. Br. 33, 34 & n.77), this latter duty of disclosure arose not only from Winans' common law duty as an employee but from his employer's explicit requirements: the district court specifically found that "it was part of [Winans'] job" to "tell his editors if he heard that word was out about a column's topic" (Pet. App. 37a).[24]

Winans' conceded violation of these duties was not, as petitioners like to suggest, merely a breach of his employer's workrules and a failure to tell about it. The success of petitioners' scheme depended on Winans' continuing, fictitious *pose* as a loyal employee. Petitioners *used* the Journal's misimpression that Winans was a loyal employee who was complying with his employer's rules to gain access to a flow of confidential information. That flow of information would not have started in the absence of Winans' at least implicit representations of loyalty; it would not have continued had Winans disabused the Journal of its mistaken belief in the continuing validity of those representations, or had he complied with his specific duty to disclose leaks of the *Heard* column.

Winans thus did more than simply break the Journal's rules or deprive the Journal of his own loyalty: he took advantage of what he knew to be the Journal's misimpression of his motives and actions to remain in a position that allowed him access to the Journal's property—confidential information—for use in a scheme that threatened an independent harm to the Journal. The

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1341 in writing the wire fraud statute. See, *e.g.*, *Herman & Maclean* v. *Huddleston*, 459 U.S. 375, 385-386 (1983); *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353, 381-382 (1982); *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978).

[24] Petitioners suggest (Pet. Br. 34 n.77) that Winans was not obligated to comply with this requirement because he himself was the one responsible for the improper disclosure of the information. But it is hardly likely that Winans' simultaneous violation of *two* duties—his improper use of confidential information and his failure to disclose the misuse of that information—insulates him from liability for both violations.

district court thus found that Winans and Felis (aided by Carpenter) acted with a specific intent to defraud the Journal (Pet. App. 72a), which included a "'specific intent to deceive'" (*id.* at 67a (citation omitted)). And the court properly concluded as well that the scheme did in fact operate as a "deceit on the Wall Street Journal" (*id.* at 71a). Such a scheme, which was possible only because the Journal relied on Winans' good faith, and which could continue only because petitioners concealed Winans' abuse of his position, was a fraud.

e. The holdings below do not, as petitioners portentously assert, convert "disobedience of any internal workrule" into "a mail or wire fraud violation, no matter how technical the rule or trivial the conduct it prohibits" (Pet. Br. 34-35).[25] This case involves deception (in the sense of a deliberate failure by one party in a relationship of trust and confidence to correct a misimpression held by the other party); it involves the use of that misimpression to obtain access, on a continuing basis, to the employer's property (here, confidential information); and it involves use of that property in a manner that not only violated the employer's rules but involved a harm to the employer independent of the employer's loss of the employee's loyal services. Courts and commentators, including those cited with approval by petitioners, have recognized that circumstances such as these demonstrate deceitful conduct that is appropriately

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[25] The misconduct here was hardly trivial. Compliance with the Dow Jones rules breached by Winans was understood to be important to the preservation of the Journal's reputation. While petitioners assert (Pet. Br. 6, 35 & n.81) that most newspapers do not have rules like the Journal's, the single newspaper story upon which petitioners rely for this surprising proposition was not admitted into evidence on the point by the district judge (see Gov't C.A. Br. 63 n.**); the government pointed to other accounts indicating that most newspapers and magazines do in fact have a policy similar to that of Dow Jones. Indeed, even the article upon which petitioners rely indicates that newspapers that lack such a formal policy nevertheless expect their employees not to trade on confidential pre-publication information.

treated as criminal under a properly cabined interpretation of the mail and wire fraud statutes. See, *e.g.*, *Lemire*, 720 F.2d at 1336-1338 (cited at Pet. Br. 29 n.57); Coffee, *supra*, 19 Am. Crim L. Rev. at 134, 167 (cited at Pet. Br. 29 n.58, 37); *id.* at 122-123 n.30 (citing cases). Indeed, as we demonstrate below, petitioners' scheme was sufficiently elaborate to require use of the mails and interstate wires for its success, a factor that is hardly likely to be true in cases involving trivial or offhand infractions of workrules.[26]

2. *Harm to the victim.* a. In addition to an element of trickery and violation of trust, it is common ground that, for a course of conduct to be prosecuted as a "scheme or artifice to defraud," it must pose a risk of harm to the victim. In this case, as both courts below explained, that requirement was amply satisfied by the danger petitioners knowingly posed to the Journal's reputation.[27] While petitioners complain that actual harm to the Journal was not established at trial (Pet. Br. 41), they acknowledge (*ibid.*)—as the courts have uniformly held—that proof of injury-in-fact is not necessary under Sections 1341 and 1343, so long as the scheme contemplated or created a risk of harm.[28] Here, both the district court and the

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[26] Petitioners' other complaints—that the Journal's rules were imposed unilaterally (Pet. Br. 33), that the decisions below give "every employer the power to decide what acts are indictable as felonies" (*id.* at 36), and that the approach taken by the lower courts creates a federal law of fiduciary obligations (*ibid.*)—are rhetorical exercises rather than substantial arguments. Petitioners were prosecuted not for traversing a work rule, but for a scheme that induced the Journal to give them access to information that they used to its detriment. See also notes 12, 13, *supra*.

[27] Injury to the Journal need not have been a goal of the scheme so long as it was a likely consequence of petitioners' activities. See 2 J. Stephen, *supra*, at 121-122.

[28] See, *e.g.*, *United States* v. *Louderman*, 576 F.2d 1383, 1387 (9th Cir.), cert. denied, 439 U.S. 896 (1978); *United States* v. *Reid*, 533 F.2d 1255, 1261 & n.24 (D.C. Cir. 1976) (citing cases); *United States* v. *Lowe*, 115 F.2d 596, 597 (7th Cir.), cert. denied, 311 U.S. 717 (1940). See generally Coffee, *supra*, 19 Am. Crim. L. Rev. at 127. The courts have reached this conclusion because Sections 1341 and 1343 make the "scheme" itself criminal, once a

court of appeals found that petitioners' scheme raised the prospect of "potentially devastating harm" to the Journal (Pet. App. 65a; see *id.* at 18a, 24a). Petitioners' argument (Pet. Br. 41) that their actions did not really put the Journal's reputation at risk is a mere quarrel with these concurrent findings of fact.

These findings by the courts below are plainly correct. The Journal itself had concluded that the misuse of its confidential information by an employee could result in "tremendous embarrassment and damage to the Company's reputation" (J.A. 41); Dow Jones adopted its rules to forestall precisely that eventuality. And petitioners' argument to the contrary sounds a particularly sour note here when placed against the district court's specific finding that "[t]he scheme's injurious consequences to the Journal must have been known to Winans" (Pet. App. 64a) and to the other participants (*id.* at 64a-65a).

b. Citing the common law of deceit and this Court's decisions in *Fasulo* v. *United States*, 272 U.S. 620 (1926), and *Hammerschmidt* v. *United States*, 265 U.S. 182 (1924), petitioners also make the broader argument (Pet. Br. 38-39 & n.95, 41 n.106) that a scheme is "fraudulent" only if it deprives the victim of money or tangible property. Whatever the limitations on the common law tort of deceit, however, this Court and the lower federal courts settled almost 100 years ago that Congress intended Section 1341 to reach beyond both the common law and other property crimes. See pages 23-24, *supra*. And *Fasulo* did not, as petitioners assert, "insist[ ] on tangible economic injury" in a prosecution

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mailing or wiring in furtherance of the fraud has taken place. Petitioners disregard this point in asserting that "the prosecution was unable to firmly establish that Winans' breaches caused any harm, economic or otherwise, to the Journal" (Pet. Br. 41 (footnote omitted)). In fact, as the district court noted (Pet. App. 63a-64a), the government introduced considerable evidence to establish that the Journal had suffered an injury; the court made no findings on the point because it found it sufficient that the scheme contemplated harm to the Journal (*id.* at 64a-65a).

under Section 1341 (Pet. Br. 41 (footnote omitted)); to the contrary, the Court there indicated in general terms that "fraud" involves "the deprivation of something of value" (272 U.S. at 627), a conclusion that reflected the understanding of the word at the time of the enactment of the mail fraud statute.[29]

Similarly, *Hammerschmidt*, far from confining "fraud" to schemes to take money or tangible property, explicitly recognized—as the Court had before (see *Haas v. Henkel*, 216 U.S. 462, 479-480 (1910)) and has since (see *United States* v. *Johnson*, 383 U.S. 169, 172 (1966))—that a conspiracy to defraud the United States under 18 U.S.C. 371 may include a scheme to "interfere with or obstruct one of [the United States'] lawful government functions" (265 U.S. at 188). And the courts of appeals have since held without exception under Sections 1341 and 1343 that "criminal fraud encompasses schemes to defraud persons of significant intangibles" (*Lemire*, 720 F.2d at 1336).[30] Indeed, a contrary conclusion would be

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[29] Legal dictionaries of the late nineteenth century, for example, defined "defraud" as meaning, among other things, "[t]o withhold from another what is justly due him, or to deprive him of a right, by deception or artifice" (W. Anderson, *supra*, at 474); the term "right" was in turn defined as "an enforceable claim or title to any subject matter whatever: either to possess or enjoy a tangible thing, or to do some act, pursue a course, enjoy a means of happiness, or to be exempt from any cause of annoyance" (*id.* at 905). See 1 *Bouvier*, *supra*, at 927. See also 2 J. Stephen, *A History of the Criminal Law of England* 121-122 (1883) (fraud involves "injury" to another).

[30] See, *e.g.*, *United States* v. *Alexander*, 741 F.2d 962 (7th Cir. 1984); *United States* v. *Frankel*, 721 F.2d 917, 920 (3d Cir. 1983) (dictum); *United States* v. *Boffa*, 688 F.2d 919, 925 (3d Cir. 1982) (citing cases), cert. denied, 460 U.S. 1022 (1983); *United States* v. *Curry*, 681 F.2d 406, 410-411 (5th Cir. 1982) (dictum); *United States* v. *Ballard*, 663 F.2d 534, 540 (1981) (dictum), modified on *reh'g*, 680 F.2d 352 (5th Cir. 1982); *United States* v. *Bohonus*, 628 F.2d 1167, 1171 (9th Cir.), cert. denied, 447 U.S. 928 (1980); *United States* v. *Reece*, 614 F.2d at 1261; *United States* v. *Condolon*, 600 F.2d 7, 8-9 (4th Cir. 1979); *United States* v. *Louderman*, 576 F.2d at 1387; *United States* v. *Castor*, 558 F.2d 379, 383 (7th Cir. 1977), cert. denied, 434 U.S. 1010 (1978); *United States*

remarkable given the realities of the modern world, where intangible interests such as information, business opportunities, goodwill, and contract rights have enormous value.

The Journal's reputation for reliability and integrity, moreover, was a concrete, pre-existing asset, independent of the Journal's interest in Winans' loyal services. Petitioners themselves recognized this, for they used that asset in their scheme: the Journal's reputation gave the *Heard* column the market punch that allowed petitioners to reap their " 'no-risk profits.' " [31] Indeed, as principles of libel and defamation law make clear, reputation—

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v. *Bryza*, 522 F.2d at 421-422. In a series of other decisions, the courts similarly have held that the corruption of a public official defrauds the citizenry by depriving it of the loyal services of the official. See, *e.g.*, *United States* v. *Silvano*, 812 F.2d 754, 758-759 (1st Cir. 1987); *United States* v. *Lovett*, 811 F.2d 979 (7th Cir. 1987); *United States* v. *Margiotta*, 688 F.2d 108 (2d Cir. 1982), cert. denied, 461 U.S. 913 (1983); *United States* v. *Mandel*, 591 F.2d 1347, 1357-1364 (4th Cir. 1979), aff'd in relevant part, 602 F.2d 653 (en banc), cert. denied, 445 U.S. 961 (1980); *United States* v. *Rabbitt*, 583 F.2d 1014, 1026 (8th Cir. 1978), cert. denied, 439 U.S. 1116 (1979); *United States* v. *Brown*, 540 F.2d 364, 374 (10th Cir. 1976); *Dixon*, 536 F.2d at 1400 (Friendly, J.) (dictum); *United States* v. *Keane*, 522 F.2d 534, 546 (7th Cir. 1975), cert. denied, 424 U.S. 976 (1976); *United States* v. *Isaacs*, 493 F.2d 1124, 1149-1150 (7th Cir.), cert. denied, 417 U.S. 976 (1974); *United States* v. *States*, 488 F.2d 761, 766 (8th Cir. 1973), cert. denied, 417 U.S. 909 (1974); *United States* v. *Edwards*, 458 F.2d 875, 880-881 (5th Cir.), cert. denied, 409 U.S. 891 (1972); *Bradford* v. *United States*, 129 F.2d 274, 276 (5th Cir.), cert. denied, 317 U.S. 683 (1942). Whether the deprivation of a public official's loyal services may support a conviction under the mail and wire fraud statutes currently is before the Court in *McNally* v. *United States*, No. 86-234, and *Gray* v. *United States*, No. 86-286.

[31] Petitioners appear to suggest (Pet. Br. 41) that the Court rejected reputation as an interest protected by the mail fraud statute when it indicated in *Fasulo* that a blackmail threat sent through the mails does not amount to a scheme to defraud. In fact, however, the Court merely suggested in that case that the scheme involved a simple threat rather than trickery or deceit; the significance of potential injury to reputation was never addressed. See 272 U.S. at 628-629.

unlike certain other interests whose deprivation also has been held to create liability under the mail and wire fraud statutes[32]—is "recognized in law as having independent value" (*Lemire*, 720 F.2d at 1336-1337 n.11). See, *e.g.*, *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 341 (1974). That is particularly true where the injury is suffered by a financial newspaper, which is able to gather information and maintain its readership precisely because of its reputation for reliability and integrity. The district court accordingly concluded that the Journal's reputation is "probably its most valuable asset" (Pet. App. 64a). By scheming to put that asset at risk, petitioners defrauded the Journal " 'as surely as if they took [its] money' " (*id.* at 18a (citation omitted)).

3. *Mailings and Wirings.* Petitioners finally argue that they did not, in the language of Sections 1341 and 1343, "cause" the mailings and wirings in this case—the wiring of Winans' column to the Journal's printing plant and the mailing of the Journal to its subscribers—"for the purpose of executing" their scheme. As they elliptically acknowledge, however, they did in fact "cause" the mailings and wirings as a matter of "general proximate causality" (Pet. Br. 45). And that concession is compelled by this Court's decisions. "Where one does an act with knowledge that use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen * * * then he 'causes' the mails to be used." *Pereira* v. *United States*,

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[32] As we note above (note 30, *supra*), for example, the courts of appeals have held that the fraudulent deprivation of an employee's loyal and honest services will support a conviction under the mail and wire fraud statutes. Petitioners attack these holdings with particular vigor (see Pet. Br. 39, 40). But petitioners' argument on this point, whatever its merits as a theoretical matter, is simply irrelevant here. Contrary to petitioners' assertion, the harm alleged by the government and found by both courts below was the threat posed by the scheme to the Journal's reputation, not the loss of Winans' loyal services (although it is manifest, of course, that the scheme did in fact deprive the Journal of Winans' loyalty).

347 U.S. 1, 8-9 (1954) (citation omitted). Here, Winans did just that by producing his columns and delivering them to his editors with the expectation that they would be wired to the Journal's printing plant and mailed to the Journal's subscribers.

These mailings and wirings, moreover, were essential to the scheme. As the district court explained, "[t]his is hardly a situation where the nexus between the mailings and wirings and the alleged fraud is too remote; without publication and distribution of the copies of the Journal containing the columns in question there would be no point to the scheme" (Pet. App. 66a (footnote omitted)). Petitioners' suggestion (Pet. Br. 43) that the mailings and wirings were "irrelevant" to their trading is for that reason wholly incorrect. Petitioners' further observations that the mailings were not directed to the victim of the fraud and that those mailings may have occurred after Winans leaked the Journal's confidential information (*id.* at 44) are simply beside the point. See, *e.g.*, *Pereira*, 347 U.S. at 4-6, 8; *United States* v. *Sampson*, 371 U.S. 75, 80-81 (1962). It is enough that the mailings and wirings were "incident to an essential element of the scheme" (*Pereira*, 347 U.S. at 8-9). And the mailings and wirings here were clearly that. See generally *United States* v. *Muni*, 668 F.2d 87, 89 (2d Cir. 1981); *United States* v. *Castor*, 558 F.2d 379, 385 (7th Cir. 1977), cert. denied, 434 U.S. 1010 (1979); *Gregory* v. *United States*, 253 F.2d 104, 109 (5th Cir. 1958). Cf. *United States* v. *Green*, 786 F.2d 247, 250 (7th Cir. 1986).

Petitioners' principal contention is that they did not cause the mailings here "for the purpose" of executing their scheme, because, they assert (a) the timing and accuracy of Winans' columns were not affected by the fraud, and (b) the columns accordingly would have been mailed and wired in the same form even in the absence of a fraud. But whatever the accuracy of these asser-

tions,[33] success of the scheme depended, as petitioners acknowledge, on "t[aking] advantage of the fact that Winans' columns would be printed and distributed" (Pet. Br. 44). Winans produced his columns, and introduced them onto the interstate wires and into the mails, with the fixed intention of using those columns (once transported) to commit a fraud. He is in no position to claim now that his use of the mails and wires in furtherance of that scheme was fortuitous, or that the arguable existence of a legitimate purpose for the mailings and wirings eliminates his manifestly fraudulent aims.[34]

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[33] Quite apart from the question whether Winans altered the timing or contents of specific columns to suit the scheme, as to which see note 4, *supra*, there is no reason to assume that the contents of the wirings and mailings would have been the same absent the scheme. Petitioners are not entitled to have Winans' profession as stock market profiteer treated as wholly incidental to his profession as journalist.

[34] Petitioners rely primarily on *Parr* v. *United States*, 363 U.S. 370 (1960) (Pet. Br. 45-46). In that case, however, the Court simply rejected the proposition that "mailings made under the imperative command of duty imposed by state law are criminal under the mail fraud statute" (363 U.S. at 391). See also *United States* v. *Curry*, 681 F.2d at 412; *United States* v. *Boyd*, 606 F.2d 792, 794 (8th Cir. 1979) (cited at Pet. Br. 46). See generally *United States* v. *Sampson*, 371 U.S. at 80. Winans, who produced his columns with the expectation of using them to commit a fraud, and who knew that his columns would not be published if he disclosed his breach of duty, plainly does not fall within this rule. The other cases relied upon by petitioners (see Pet. Br. 43 n.117, 45 n.120, 46) for the proposition that their actions failed to satisfy the mailing and wiring requirements of Sections 1341 and 1343 are simply inapposite. Those decisions held only that, on the particular facts involved, "there was not a sufficient connection between the mailing and the execution of the defendants' scheme." *United States* v. *Maze*, 414 U.S. 395, 401 (1974); *Kann* v. *United States*, 323 U.S. 88, 94 (1944); *United States* v. *Castile*, 795 F.2d 1273, 1278-1281 (6th Cir. 1986); *United States* v. *Taylor*, 789 F.2d 618, 622-623 (8th Cir. 1986); *United States* v. *Tarnopol*, 561 F.2d 466, 471-472 (3d Cir. 1977).

B. Petitioners' Trading In Securities On Fraudulently Acquired, Market-Affecting Information Violated Section 10(b) Of The Securities Exchange Act Of 1934 And Rule 10b-5 Thereunder

Petitioners used the information that they fraudulently misappropriated from the Journal to "'reap instant no-risk profits in the stock market'" (Pet. App. 19a-20a, quoting *SEC* v. *Materia*, 745 F.2d 197, 203 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985)). Indeed, the purpose of their misappropriation was to take advantage of investors who "would not have purchased or sold, at least at the transaction prices, had they had the benefit of [the fraudulently acquired] information" (Pet. App. 18a). Petitioners nevertheless assert that, because the information that gave them this advantage was misappropriated from the Journal rather than from a "market participant" that was itself trading securities, their conduct was outside the "protective zone" (Pet. Br. 15) of Section 10(b), the Exchange Act's "catchall" anti-fraud provision. *Herman & Maclean* v. *Huddleston*, 459 U.S. 375, 382 (1983). See *Chiarella*, 445 U.S. at 226.

Petitioners' argument misconceives both the purpose and the theory of the prosecution here. Petitioners were prosecuted not to correct a private wrong, but to further the Exchange Act's fundamental purpose of "insur[ing] the maintenance of fair and honest markets in [securities] transactions." 15 U.S.C. 78b. And petitioners were not charged on the theory that they were "insiders" of the corporations whose stock they traded, who for that reason owed a duty of disclosure to the shareholders on the other side of their transactions. Petitioners were prosecuted and convicted on the theory that "misappropriation of confidential information by a fiduciary" for use in trading securities violates Section 10(b) and Rule 10b-5. *United States* v. *Newman*, 664 F.2d 12, 18 (2d Cir. 1981), aff'd after remand, 722 F.2d 729 (2d Cir.) (Table), cert. denied, 464 U.S. 863 (1983). The elimination of that sort of "cunning device" (*Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976) (brackets omit-

ted)) from trading is a central purpose of the securities laws.

1. Section 10(b) (emphasis added) makes it unlawful for "*any* person," "directly or indirectly," to use "in connection with the purchase or sale of *any* security * * * *any* manipulative or deceptive device or contrivance" in violation of rules promulgated by the SEC. Rule 10b-5 (emphasis added) in turn prohibits "*any* person" from engaging in "*any* act [or] practice" that "operates or would operate as a fraud or deceit upon *any* person" in connection with a purchase or sale of securities. This Court has consistently construed these provisions broadly, noting that Section 10(b) is "a 'catchall' clause to enable the Commission to 'deal with new manipulative or cunning devices'" (*Hochfelder*, 425 U.S. at 203 (brackets omitted)). The statute and rule thus "'prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception.'" *Bankers Life*, 404 U.S. at 11 n.7 (quoting *A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) (emphasis in original)). See *Huddleston*, 459 U.S. at 386; *United States* v. *Naftalin*, 441 U.S. 768, 773 (1979); *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972). See also S. Rep. 792, 73d Cong., 2d Sess. 6 (1934).

Petitioners' fraudulent misappropriation and use of confidential information in breach of a duty of trust was a fraud on "any person"—The Wall Street Journal.[35]

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[35] In the report accompanying the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264, the House explained that "[i]n other areas of the law, deceitful misappropriation of confidential information by a fiduciary * * * has consistently been held to be unlawful;" it added that Congress "has not sanctioned a less rigorous code of conduct under the federal securities laws." H.R. Rep. 98-355, 98th Cong., 1st Sess. 5 (1983). Indeed, the idea that misappropriation of confidential information constitutes a fraud has particular force in the securities area. See *Materia*, 745 F.2d at 198-199. See generally *Bateman Eichler, Hill Richards*,

Indeed, petitioners assume this to be true for purposes of their discussion of the securities counts in this case (Pet. Br. 10); since they "misappropriated—stole to put it bluntly—valuable nonpublic information entrusted to [them] in the strictest confidence" (*Chiarella*, 445 U.S. at 245 (Burger, C.J., dissenting)), they could hardly contend otherwise. It is equally clear that a fraud of this sort is, vis-a-vis the defrauded party, a "deceptive practice"—a proposition that petitioners also do not contest. Compare *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 474 (1977) (no deception).

That fraud, moreover—the misappropriation of information for the purpose of trading—plainly occurred "in connection with" petitioners' purchases and sales of securities. Without the fraud their purchases and sales would not have occurred, "at least at the transaction prices." Pet. App. 18a; see *id.* at 19a-20a. Indeed, "the misappropriated information had 'no value whatsoever' * * * except 'in connection with' [petitioners' subsequent purchase[s and sales] of securities" (*id.* at 19a (quoting *Materia*, 745 F.2d at 203)). Thus, "[t]he fraud perpetrated on [Winans'] employer was part and parcel of a larger design, the sole purpose of which was to reap instant no-risk profits in the stock market" (*Materia*, 745 F.2d at 203). See generally *Naftalin*, 441 U.S. at 772-773 & n.4. The court below accordingly found "frivolous" petitioners' contention that the "in connection with" requirement had not been satisfied in this case (Pet. App. 20a), and petitioners have not expressly repeated that contention to this Court.

2. Petitioners nevertheless argue, at length and in a variety of formulations, that their fraud fell outside the "protective zone of section 10(b)" (Pet. Br. 15) because it did not involve breach of "a duty * * * to a market participant" (*id.* at 17).[36] They appear to mean by this

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Inc. v. *Berner*, 472 U.S. 299, 310 (1985); *Huddleston*, 459 U.S. at 388-389.

[36] At various points, petitioners suggest that the victim of a violation of Section 10(b) and Rule 10b-5 must be an "investor[]

assertion either (a) that Section 10(b) and Rule 10b-5 are violated only by classic "insider trading" (in violation of a fiduciary duty owed by a corporate insider to the shareholders of the subject corporation) (see Pet. Br. 17), or (b) that while trading on information misappropriated from a third party may also violate Section 10(b) and Rule 10b-5, it does so only when the third party is itself a market participant (see Pet. Br. 19-20). Both proposed limitations are incorrect.

a. Petitioners' contentions are, first of all, flatly inconsistent with the language of both the statute and the rule. Section 10(b) prohibits the "direct[] or indirect[]" use of "any" deceptive device in connection with the purchase or sale of "any" security. Rule 10b-5 explicitly proscribes "any * * * fraud" committed on "any person." As the Court has explained, these "proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive." *Affiliated Ute Citizens*, 406 U.S. at 151. See generally *Huddleston*, 459 U.S. at 386-387.

Rather than discuss the language of Section 10(b) or Rule 10b-5,[87] petitioners suggest (see Pet. Br. 13-19) that this Court has effectively limited the reach of Section 10(b) to classic insider trading that violates a fiduciary duty to the person on the other side of the trade. But as the courts below noted (Pet. App. 12a, 57a), the cases

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or person[] engaged in the process of buying or selling stock" (Pet. Br. 14); a person with a role in "the underlying securities transaction" (*ibid.*); a "market participant" (*id.* at 15); or someone "involve[d] in the purchase or sale of securities" (*id.* at 17). But petitioners also evidently realize that the victim of the fraud need not be a purchaser or seller of securities (Pet. Br. 15-16 n.24). That proposition was established by the Court's holding in *United States* v. *Naftalin*, *supra*, that Section 17(a)(1) of the Securities Act—which contains language nearly identical to that of Rule 10b-5—does not "create[] a requirement that injury occur to a purchaser." 441 U.S. at 773.

[87] Not surprisingly, petitioners mention the language of Section 10(b) and Rule 10b-5 only in passing. Their only discussion of the statutory language is the irrelevant suggestion that "manipulation" (which was not alleged in this case) refers to the artificial

upon which petitioners rely for this proposition—*Chiarella* v. *United States*, *supra*, and *Dirks* v. *SEC*, 463 U.S. 646 (1983)—say no such thing. These cases do explain that the liability of a corporate insider or his tippee for trading on nonpublic information is premised on the particular duty of the insider to persons trading in the stock of that corporation, and they hold that there is no liability for trading on disparities in information where there has been *no* breach of *any* duty to *anyone*. See 463 U.S. at 653-654; 445 U.S. at 228-230. See generally *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). But these cases did not purport to "wr[i]te the book on insider and outsider trading; [they] wrote one chapter with respect to one type of fraudulent trading" (Pet. App. 57a).[38] Neither these cases nor any other decision of this Court has suggested that a fraud intentionally practiced on a third party, for the purpose of gaining an unfair advantage in securities trading, violates Section 10(b) only if the per-

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stimulation of market activity for the purpose of misleading investors. Pet. Br. 14 n.22. See generally *Santa Fe Industries*, 430 U.S. at 475-476.

[38] Quoting *Dirks* and *Hochfelder*, petitioners assert that this Court has held that " 'a violation [of Section 10(b)] may be found *only* where there is "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." ' " Pet. Br. 14 (quoting *Dirks*, 463 U.S. at 663 n.23, in turn quoting *Hochfelder*, 425 U.S. at 199) (emphasis added by petitioners). This assertion is highly misleading. The Court in *Hochfelder* made the quoted remark in a discussion of the meaning of the term "manipulation," and nowhere suggested that Section 10(b) does not reach frauds on third parties in connection with securities trading. The Court in *Dirks*, in turn, used the quoted statement while discussing the necessity of scienter in cases involving insider trading. In full, the Court's statement reads: "It is not enough that an insider's conduct results in harm to investors; rather, a violation may be found only where there is 'intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.' " 463 U.S. at 663 n.23. Because the fraud in such cases is committed on the insider's trading partners, the Court obviously directed its remarks at fraud on investors.

petrator owes an antecedent duty to his trading partners.[39]

To the contrary, the Court in *Chiarella* expressly noted and left open the possibility that a person who owes no corporate-law duty to the subject corporation's shareholders may violate Section 10(b) and Rule 10b-5 by trading on information misappropriated from a third party. See 445 U.S. at 235-237. Cf. *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 313 n.22 (1985). And the four Justices who addressed the validity of this "misappropriation theory" of liability in *Chiarella* concluded that "a person violates § 10(b) whenever he improperly obtains or converts to his own benefit nonpublic information which he then uses in connection with the purchase and sale of securities" (445 U.S. at 239 (Brennan, J., concurring in the judgment)).[40] In the succeeding years,

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[39] Other cases cited by petitioners (Pet. Br. 15-16) either involved the classic insider trading theory or involved limitations, irrelevant here, on private suits brought by injured parties under Rule 10b-5. See page 48, *infra*.

[40] See 445 U.S. at 240 (Burger, C.J., dissenting) ("a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading"); *id.* at 245-246 (Blackmun, J., joined by Marshall, J., dissenting) (expressing general agreement with Chief Justice Burger's views and noting that Chiarella's conversion of confidential information "certainly is the most dramatic evidence that petitioner [is] guilty of fraud"). The majority found it inappropriate to address the validity of the misappropriation theory in *Chiarella* because the theory had not been submitted to the jury. See *id.* at 235-237; *id.* at 238 (Stevens, J., concurring). In Chief Justice Burger's view, an exception to the usual principles of caveat emptor should apply "when an informational advantage is obtained [by one party to a transaction], not by superior experience, foresight, or industry, but by some unlawful means"; in such a case, he would require the party who obtains the information unlawfully to disclose the information or to refrain from trading. *Id.* at 240 (citing Keeton, *supra*, 15 Tex. L. Rev. at 25-26). But cf. *Moss* v. *Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983), cert. denied, 465 U.S. 1025 (1984) (dismissing a private action for damages, by investors trading in

this misappropriation theory has received the endorsement both of committees of Congress[41] and of the lower courts, which have consistently upheld application of Section 10(b) and Rule 10b-5 against persons who traded on confidential information fraudulently misappropriated from employers or clients.[42]

The misappropriation theory fills what would otherwise be a large and illogical loophole in the securities laws. A

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the market, against persons who traded on misappropriated information).

Chief Justice Burger's legal theory was that trading on misappropriated information is a wrong not only to the owner of the information but also to the person on the other side of the transaction. Petitioners repeatedly stress that the government did not here allege injury to any trading partner, as if that defeated prosecution. But Chief Justice Burger's theory suggests no such pleading requirement: the relevant point of disagreement in *Chiarella* was whether there was an adequate jury charge of fraudulent *misappropriation* of information. Believing that there was, Chief Justice Burger would have affirmed the conviction under the securities laws on the ground that Chiarella " 'used that information when he knew other people trading in the securities market did not have access to the same information that he had at a time when he knew that that information was material to the value of the stock' " (*Chiarella*, 445 U.S. at 243-244 (quoting jury charge)). Here, the government plainly alleged and proved fraudulent misappropriation of confidential, market-affecting information, and trading on that information without disclosure. It was not necessary for the indictment to explicate the legal theory that such conduct violates the securities laws because of its effect on other investors and the integrity of the market.

[41] The report accompanying the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264, emphasizes that "the abuses sought to be remedied [by Section 10(b)] were not limited to action of corporate insiders" (H.R. Rep. 98-355, 98th Cong., 1st Sess. 5 (1983)), and expressly endorses both the misappropriation theory (see *id.* at 4-5) and decisions applying the theory (see *id.* at 13 n.20). The Court has previously found this report relevant in construing Section 10(b) and Rule 10b-5. See *Bateman Eichler*, 462 U.S. at 313 n.23.

[42] See, *e.g.*, *SEC* v. *Materia*, *supra*; *United States* v. *Newman*, *supra*; *SEC* v. *Gaspar*, [1984-1985] Fed. Sec. L. Rep. (CCH) ¶ 92,004 (S.D.N.Y. Apr. 15, 1985); *SEC* v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984).

person who trades on information that he fraudulently misappropriated from a takeover bidder, from an investment banker analyzing a possible acquisition for a client, or for that matter from any entity other than the corporation whose stock is being traded, is ordinarily not a corporate insider of that corporation (or an insider's tippee) and ordinarily has no insider's duty of disclosure to the stockholders of that corporation. See generally *Dirks*, 463 U.S. at 659. In such cases—which unfortunately occur with some frequency [43]—the theory of the prosecution is that trading on fraudulently misappropriated information violates Section 10(b) even if the defendant is not an insider and the information does not originate in the target company.[44]

The misappropriation theory does more than follow from a literal reading of Section 10(b) and Rule 10b-5. It also furthers the central purpose of the Exchange Act:

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[43] For recent cases based at least in part on the misappropriation theory, see, *e.g.*, *SEC* v. *Siegel*, No. 87 Civ. 0963 (S.D.N.Y. Feb. 13, 1987) (disgorgement of $4.3 million in illegal profits and other assets); *SEC* v. *Boesky*, No. 86 Civ. 8767 (S.D.N.Y. Nov. 14, 1986) (disgorgement of $50 million in illegal profits and $50 million penalty); *SEC* v. *Tome*, 638 F. Supp. 596 (S.D.N.Y. 1986), appeal pending No. 86-6192(L) (2d Cir.) (disgorgement of $2.7 million in illegal profits); *SEC* v. *Levine*, No. 86 Civ. 3726 (S.D.N.Y. June 5, 1986) (disgorgement of $11.6 million in illegal profits).

[44] In certain situations, Rule 14e-3, 17 C.F.R. 240.14e-3, promulgated under Section 14(e) of the Exchange Act, 15 U.S.C. 78n(e), prohibits trading while in possession of material nonpublic information relating to a tender offer that has been acquired from the offeror, the target, or any agent or employee of either party. In such situations, trading may violate both Rule 10b-5 and Rule 14e-3. But Rule 14e-3 does not reach cases where the information does not concern a tender offer (but instead, for example, a merger), or where the source of the information is not a party to a tender offer. Noting the limits of Rule 14e-3, one commentator has suggested the example of "a judicial clerk [who sells] shares of a particular company on the basis of his knowledge that a huge judgment would soon be rendered against it." Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101, 106 n.33 (1984).

"to insure the maintenance of fair and honest markets in [securities] transactions." 15 U.S.C. 78b.[45] In its first consideration of a private civil action under Rule 10b-5, the Court noted that basic purpose of Section 10(b) is "'preserving the integrity of the securities market'" (*Bankers Life*, 404 U.S. at 12 (citation omitted)), a goal that serves the interests both of individual investors and of the market as a whole. See *Naftalin*, 441 U.S. at 776. The only specific legislative history of Section 10(b), the Exchange Act's catchall antifraud provision, confirms that the clause had the equally broad purpose of eliminating from the securities markets all "manipulative and deceptive practices which have been demonstrated to fulfill no useful function." S. Rep. 792, 73d Cong., 2d Sess. 6 (1934). Section 10(b) (emphasis added) thus expressly authorizes the Commission to adopt rules that are "necessary or appropriate in the public interest *or* for the protection of investors."

The present case dramatically illustrates the damage to the "public interest" that flows from the use of fraudulently misappropriated information in securities trading. As the court of appeals observed with some understatement, there was nothing "'useful' about [petitioners'] scheme" (Pet. App. 13a); their "information advantage [was] obtained by conversion and not by legitimate economic activity that society seeks to encourage" (*Chiarella*, 445 U.S. at 242 n.3 (Burger, C.J., dissenting)). See *id.* at 241. Compare *Dirks*, 463 U.S. at 658-659. Such conduct has a profoundly negative effect on the functioning of the securities markets. It is a commonplace—often noted by commentators, by those involved in regulation of the markets, and by committees of Congress—that

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[45] As the House Committee explained in connection with the major amendments to the Exchange Act in 1975: "The basic goals of the Exchange Act remain saluta[]ry and unchallenged: To provide fair and honest mechanisms for the pricing of securities, to assure that dealing in securities is fair and without undue preference or advantages among investors * * * and to provide, to the maximum degree practicable, markets that are open and orderly." H.R. Conf. Rep. 94-229, 94th Cong., 1st Sess. 91-92 (1975).

"[t]he abuse of informational advantages that other investors cannot hope to overcome through their own efforts is unfair and inconsistent with the investing public's legitimate expectation of honest and fair securities markets where all participants play by the same rules." H.R. Rep. 98-355, *supra*, at 5.[46] The use of illegally acquired information to obtain an advantage in trading thus "undermin[es]" public confidence in the honesty of securities transactions, inevitably driving investors out of the market and threatening both "[c]apital formation and our nation's economic growth and stability." *Id.* at 2. See 129 Cong. Rec. S3865 (daily ed. Mar. 23, 1983) (remarks of Sen. D'Amato; 130 Cong. Rec. H7759 (daily ed. July 25, 1984). (remarks of Rep. Wirth); ABA Committee on Federal Regulation of Securities, *Report of the Task Force on Regulation of Insider Trading—Part I: Regulation Under the Antifraud Provisions of the Securities Exchange Act of 1934*, 41 Bus. Law. 223, 227-228 & n.8 (1985).[47]

Trading on fraudulently misappropriated information also, of course, injures investors, both individually and as a class. Petitioners, for example, exploited the information they misappropriated "for [their own] financial benefit * * * and to the financial detriment of those investors with whom [they] traded"; "those who pur-

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[46] See ABA Committee on Federal Regulation of Securities, *supra*, 41 Bus. Law. at 227; Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 346 (1979); Aldave, *supra*, 13 Hofstra L. Rev. at 122-123.

[47] As the Insider Trading Task Force of the ABA Committee on Federal Regulation of Securities observed, "people will not entrust their resources to a marketplace they don't believe is fair, any more than a card player will put his chips on the table in a poker game that may be fixed. Although the task force knows of no empirical research that directly demonstrates that concerns about integrity affect market activity, both authoritative commentators and common sense tell us that if investors do not anticipate fair treatment, they will avoid investing in securities. As a result, capital formation through securities offerings will become less attractive and more difficult." 41 Bus. Law. at 227-228 (footnote omitted).

chased or sold securities without the misappropriated information would not have purchased or sold, at least at the transaction prices, had they had the benefit of that information" (Pet. App. 18a). More broadly, as the Court has observed, the well-being of investors is inextricably linked to the health of the market and of the economy as a whole. See *Naftalin*, 441 U.S. at 776. Petitioners' conduct inflicted a wound on the market and all of the participants in it.

b. Petitioners themselves appear at various points (see, *e.g.*, Pet. Br. 19) to concede that trading on fraudulently misappropriated information may violate Rule 10b-5. They seem to recognize, for example, that trading on information misappropriated from a takeover bidder is unlawful, even when the defendant traded neither with the bidder nor in the bidder's shares (*id.* at 19-20). They argue, however, that while trading on confidential information misappropriated from a "market participant" may violate Section 10(b) and Rule 10b-5, the identical use of similar information purloined from a market *observer* such as the Journal does not (see Pet. Br. 19-22).

Petitioners offer absolutely no justification for their stopping place for Section 10(b) liability—which finds no support in the language of the statute or Rule 10b-5—beyond the bald assertion that the first category of these frauds falls within, and the second without, the "protective zone of [Section] 10(b)" (Pet. Br. 15).[48] But a principal purpose of the Exchange Act as a whole, and

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[48] Relying on the dissenting opinion below, petitioners do argue that the misappropriated information here did not involve " 'special securities-related knowledge' " (Pet. Br. 21 (quoting Pet. App. 29a)). As the court of appeals noted, however, the information taken by petitioners unquestionably was material; the *Heard* column had immediate effects on the market prices of the securities that it discussed (Pet. App. 19a n.9). See *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). Petitioners themselves obviously believed that their advance knowledge of the Journal's publication plans was significant, for their entire scheme was premised on their ability to trade securities prior to publication and then to profit from the market's response.

of the misappropriation doctrine in particular, is to foster orderly competition for information, guarantee honest markets, and maintain investor confidence. See pages 43-46, *supra*. The fact that the *owner* of the purloined information is not itself trading has absolutely no bearing on the fact that the thief who does trade on that information is corrupting the trading process, creating a disincentive to research and analysis, gaining an improper advantage over honest investors, and discouraging those investors from participating in the market. It is hardly a novel idea that the deception of one person may also, in this way, injure others.[49] Here, petitioners' fraud not only harmed the Journal but also damaged the integrity of the market as a whole. Conduct that can cause such damage must, to use petitioners' language, fall within the "zone" proscribed by Section 10(b).

Certainly, trading on information misappropriated from a takeover bidder or other securities trader also violates Section 10(b) and Rule 10b-5 in connection with *that person's* purchases and sales of securities. See, *e.g.*, *Newman*, 664 F.2d at 17-18. But both a "connection" with purchases or sales of securities and a fundamental harm to the integrity of the market are present *whenever* trading is based on fraudulently misappropriated information. Petitioners' proposed limitation of misappropriation liability to cases where the owner of the information is injured in respect of *its* trading would, to take just one example, lead to the absurd conclusion that trading on information misappropriated from an investment banker is outside the "zone" of conduct regulated by Section 10(b) whenever the information belongs to the investment banker and not to a market participant.

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[49] See, *e.g.*, *Bohannon* v. *Wachovia Bank & Trust Co.*, 210 N.C. 679, 188 S.E. 390 (1936) (testator deceived into disinheriting plaintiff); *Mitchell* v. *Langley*, 143 Ga. 827, 85 S.E. 1050 (1915) (holder of life insurance policy fraudulently induced to change beneficiaries). See generally Aldave, *supra*, 13 Hofstra L. Rev. at 120.

Of course, only a purchaser or seller of securities may bring a suit for damages under Rule 10b-5's judicially created private right of action, and such a plaintiff must prove injury to himself. See *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). But limitations on the recovery of damages in private suits are grounded on considerations of policy that have no application in actions brought by enforcement authorities to vindicate the public interest. See *id.* at 740-747; *id.* at 757-760 (Powell, J., concurring). Indeed, the Court has expressly indicated that the purchaser-seller limitation "is inapplicable" in criminal prosecutions or SEC civil enforcement actions for securities fraud. *Naftalin*, 441 U.S. at 774 n.6. See *Blue Chip Stamps*, 421 U.S. at 753 n.14; *SEC* v. *National Securities, Inc.*, 375 U.S. 453, 467 n.9 (1969). In such cases, " 'the precise direction in which a duty may have been owed' " (*Materia*, 745 F.2d at 202 (citation omitted)) is immaterial so long as deceitful conduct was practiced, "directly or indirectly," in connection with the purchase and sale of securities.[50]

3. Petitioners' remaining contentions also lack merit. There would be nothing anomalous in the application of Rule 10b-5 to petitioners even if it were true, as they assert (Pet. Br. 22), that Dow Jones could have traded

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[50] Petitioners place considerable reliance (Pet. Br. 15) on then-Judge Stevens' opinion for the Seventh Circuit in *Eason* v. *General Motors Acceptance Corp.*, 490 F.2d 654, 659 (1973), cert. denied, 416 U.S. 960 (1974), for the proposition that a violation of Rule 10b-5 occurs only when the injured party is an "investor." Because the injured party in that case was in fact an investor, however, and because the action was a private suit for damages, there was no reason for the court of appeals in *Eason* to determine whether, in a government enforcement action, the victim of the fraud must have been an investor. Indeed, Justice Stevens has explained more recently that "the limitation on the right to recover pecuniary damages in a private action [under Rule 10b-5] * * * is not necessarily coextensive with the limits of the rule itself." *Chiarella*, 445 U.S. at 238 (Stevens, J., concurring). And the Court's decision in *United States* v. *Naftalin*, *supra*, makes clear that a securities fraud need not be directed at a purchaser or seller—or, for that matter, at an investor. See note 36, *supra*.

on *its* knowledge of forthcoming *Heard* columns.[51] As the court of appeals noted (Pet. App. 21a), petitioners' argument "illogically casts the thief and [his] victim in the same shoes." There are, of course, situations in which it is perfectly proper for the owner to trade on information that a thief may not use in trading; for example—as petitioners appear to acknowledge (Pet. Br. 19-20)—a tender offeror may make pre-announcement purchases of target company stock for its own account (although the Williams Act, 15 U.S.C. 78m(d)(1), imposes post-purchase disclosure requirements), but an employee of the offeror (or its printer) commits a fraud if he misappropriates information about the offeror's plans in order to trade for himself. See *Chiarella*, 445 U.S. at 240 (Burger, C.J., dissenting); *Materia*, 745 F.2d at 201-203.[52] Here,

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[51] In fact, the court of appeals expressly left open the question whether that pre-publication trading by a financial newspaper would work a fraud under a different legal theory than the one involved in this case (Pet. App. 20a n.10). Cf. *Zweig* v. *Hearst Corp.*, 594 F.2d 1261 (9th Cir. 1979) (scalping theory of liability under Rule 10b-5); *SEC* v. *Blavin*, 557 F. Supp. 1304 (E.D. Mich. 1983), aff'd, 760 F.2d 706 (6th Cir. 1985) (scalping) (both cited with apparent approval in *Lowe* v. *SEC*, 472 U.S. 181, 209-210 n.56 (1985)).

[52] As the court of appeals explained, the misappropriation theory does not at all suggest a "parity of information" rule (Pet. App. 15a-16a). To the contrary, prohibiting trading on misappropriated information encourages lawful competition for superior knowledge and insight, which is essential to the market's functioning. See *Dirks*, 463 U.S. at 658-659. While someone may trade on superior information gained in any number of legal ways, it is improper to obtain such an informational advantage by "misappropriating material nonpublic information in breach of an employer-imposed fiduciary duty of confidentiality" (Pet. App. 16a).

If the Journal had expressly permitted its employees to trade on confidential information, Winans' actions obviously would not have amounted to a fraud on his employer (although a publication that allowed its employees to engage in such conduct would soon lose the reputation for reliability and integrity that makes the information valuable in a scheme such as the one here). We note, however, that the simple absence of an express policy like the Journal's would not justify employee trading, since, as the court

on the other hand, it would have been unethical and against its self-interest (as reflected in the rules that Winans broke), for Dow Jones to have traded on information about its publication schedule, but there is no anomaly in relying on the owner's integrity and self-interest to deter its misuse of its own information, while prohibiting such misuse by a thief.

Petitioners' further contention that they lacked notice of the illegality of their conduct (Pet. Br. 23-28) is simply incorrect. In fact, the district court specifically found that Felis "understood" that he was involved in "an unlawful venture" (Pet. App. 71a), and the court found generally that petitioners were aware that their acts were wrongful (*id.* at 69a). They surely " 'would have [been] most ingenuous' " to have believed otherwise (*ibid.* (citation omitted)). Notwithstanding petitioners' rhetorical questions (see Pet. Br. 25-26), it has long been the law that deceitful use of confidential information obtained from an employer is unlawful in a variety of settings. See *Newman*, 664 F.2d at 18 (citing cases). By the time of petitioners' scheme, the Second Circuit had expressly so ruled in *Newman* itself, a case involving Section 10(b) and Rule 10b-5. See also Pet. App. 22a (citing cases).[53] Petitioners are hardly entitled to immunity because their scheme differed in some particulars from the ones previously prosecuted: "that there is no litigated fact pattern precisely in point may constitute a tribute to the cupidity and ingenuity of the malefactors involved but hardly provides an escape from the penal sanctions of the securities fraud provisions."

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below recognized (Pet. App. 10a n.5), the common law itself imposes duties on employees not to use their employer's confidential information to the employer's detriment. See note 13, *supra*.

[53] Indeed, a congressional report on trading abuses issued shortly before petitioners began to trade on the Journal's information cited the Second Circuit's decision in *United States* v. *Newman*, *supra*, as having helped "clarif[y] the legal principles governing * * * cases that involve trading on information that originates from sources other than the company [whose shares are being traded]." H.R. Rep. 98-355, *supra*, at 13 n.20.

United States v. *Brown*, 555 F.2d 336, 339-340 (2d Cir. 1977).[54]

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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MAY 1987

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[54] Finally, we note that the suggestion of *amici* Reporters Committee for Freedom of the Press, *et al.*, that the prosecution here somehow raises First Amendment concerns (Br. 19-25) is preposterous. A generally applicable criminal law can constitutionally be applied to a criminal whose nominal profession is journalism. A newspaper might be "chilled" (see Br. 22) in deciding whether to publish a given article because publication would reveal that its reporter committed burglary to obtain the information on which the article is based, but that hardly makes burglary laws unconstitutional as applied to members of the press. Section 10(b) and Rule 10b-5 similarly create a general prohibition against the fraudulent use of an employer's confidential information in connection with the purchase or sale of securities, and there is no reason to exempt reporters from this requirement. Affirmance of the decision below will discourage reporters from doing only one thing: committing securities fraud. We also note that amici's wildly unrealistic hypothetical (Br. 20-21) has nothing to do with the issues in this case; the only editorial decision affected by Winans' fraud was Winans' quick departure from the Journal.

STATUTORY APPENDIX

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

18 U.S.C. 371 provides:

> If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

18 U.S.C. 1341 provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, secu-

rity, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting to do so, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

18 U.S.C. 1343 provides:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

17 C.F.R. 240.10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements

made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

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No. 86-422

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OCTOBER TERM, 1987

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v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL BRIEF FOR THE UNITED STATES

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SUPPLEMENTAL BRIEF FOR THE UNITED STATES

This brief is filed pursuant to Rule 35.5 of the Rules of this Court to address the significance to this case of *McNally* v. *United States*, No. 86-234 (June 24, 1987), which was decided after the submission of the government's brief on the merits. In *McNally*, the Court held that the federal mail fraud statute, 18 U.S.C. 1341, proscribes " 'wronging one in his property rights by dishonest methods or schemes' " (slip op. 8 (citations omitted)), but does not reach "schemes to defraud citizens of their intangible rights to honest and impartial government" (*id.* at 5).

McNally does not affect petitioners' convictions under the mail and wire fraud statutes. Petitioners were *not* convicted because they deprived the Journal of Winans' loyalty, or of some other abstract expectation. As the district court explained in some detail (see Pet. App. 63a-65a)—in findings endorsed by the court of appeals (see *id.* at 18a)—petitioners' convictions were based squarely on their fraudulent misappropriation of proprietary information about the contents and timing of the *Heard* column. The Journal explicitly (and correctly)

considered this information to be its property (Pet. App. 36a), and the misappropriation of that property by petitioners plainly interfered with the Journal's right to control its use. Petitioners' actions also threatened to reduce the interest of readers in, and thus the value to the Journal of, the *Heard* column, a continuing newspaper feature that was regarded by Journal editors as "one of the most important" of the newspaper's columns (C.A. App. 118). And the fraud threatened "potentially devastating harm" (Pet. App. 65a) to a closely related Journal asset: the worldwide reputation for fairness and integrity that gives value to all of the Journal's columns and features.[1]

Nor does *McNally* affect petitioners' convictions under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The offense defined by those provisions does not require an injury to property. Section 10(b) and Rule 10b-5 were designed to help "insure the maintenance of fair and honest markets in [securities] transactions," 15 U.S.C. 78b, and these provisions make no reference to "money or property." Instead, the limiting principle in cases under these provisions is that the fraud must occur "in connection with the purchase or sale of any security," an element that is plainly present here.

1. a. *McNally* does not alter the rule that nondisclosure by a person in a position of trust may constitute a

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[1] The district court summarized this harm as follows (Pet. App. 64a-65a):

> [T]he fraudulent misappropriation or theft of the WSJ's property is in itself sufficient to satisfy the requirement of contemplation of harm. The theft of valuable property is of course a crime even if the victim is unaware of the loss. Here, the fraudulent taking and misuse of the confidential information stolen from the WSJ placed immediately in jeopardy probably its most valuable asset—its reputation for fairness and integrity. These conspirators, with their intimate knowledge of the financial and stock markets and of the influential role that the Heard column played in these markets, were hardly unaware of the potentially devastating harm that their fraudulent acts could cause to the WSJ.

" 'trick, deceit, chicane or overreaching' " (slip op. 8 (citation omitted)) sufficient to establish the existence of a scheme or artifice to defraud. This Court had previously made clear that a person commits fraud when he fails to disclose "information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them' " (*Chiarella* v. *United States*, 445 U.S. 222, 228 (1980) (citation omitted)), and nothing in *McNally* casts doubt on that established rule. Indeed, *McNally* is not at all concerned with the *means* by which the defendant effects his scheme; it addresses only the requisite injury to the victim. Cf. *McNally*, slip op. 10 (suggesting that breach of fiduciary duty may amount to fraud if it wrongs the victim in his property rights); *id.* at 11 (Stevens, J., dissenting). Here, as we have previously explained (Gov't Br. 14-27), Winans' knowing breach of duties to the Journal (including, among others, the duty to disclose leaks of the *Heard* column (Pet. App. 37a)) afforded him continuing access to the Journal's confidential information about the contents and timing of the *Heard* column, which he and the other petitioners then misappropriated. That conduct clearly establishes the first element of the crime.

b. With respect to the second element—the requirement under 18 U.S.C. 1341 and 1343 that a scheme to defraud contemplate harm to the victim (see Gov't Br. 14)—the specific holding of *McNally* is that the mail fraud statute does not "proscribe[] schemes to defraud citizens of their intangible rights to honest and impartial government" (slip op. 5); the Court concluded that the statute is "limited in scope to the protection of property rights" (*id.* at 10). But nothing in the Court's opinion suggests that Section 1341 fails to protect well-established forms of intangible property—a reading that would dramatically narrow the reach of a statute that "has been characterized as the 'first line of defense' against virtually every new area of fraud to develop in the United States in the past century" (Rakoff, *The Fed-*

eral Mail Fraud Statute (Part I), 18 Duq. L. Rev. 771, 772 (1980) (citation omitted)). To the contrary, the Court emphasized in *McNally* that the mail fraud statute "is to be interpreted broadly insofar as property rights are concerned" (slip op. 6). The "right of the citizenry to good government" at issue in *McNally* (slip op. 5) cannot be valued in monetary terms, and no individual has an enforceable possessory interest in it (cf. slip op. 9 n.8). But many intangibles have monetary value and belong to identifiable persons who are entitled to exclude other persons; such intangibles are universally thought of as "property."

While the Court in *McNally* did not define "property" for purposes of the mail and wire fraud statutes, the term surely includes many kinds of valuable proprietary information such as trade secrets, customer lists, business plans, financial analysis and advice, and the like. The misappropriation of such information has long been understood to deprive the owner of something of value (see generally *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1001-1004 (1984); *International News Service* v. *Associated Press*, 248 U.S. 215 (1918); *United States* v. *Girard*, 601 F.2d 69, 70-71 (2d Cir.), cert. denied, 444 U.S. 871 (1979); *NCH Corp.* v. *Broyles*, 749 F.2d 247, 254 (5th Cir. 1985); *Vigitron, Inc.* v. *Ferguson*, 120 N.H. 626, 419 A.2d 1115 (1980)), and to give rise to liability under the mail and wire fraud statutes (see, *e.g.*, *United States* v. *Kent*, 608 F.2d 542, 545 (5th Cir. 1979), cert. denied, 446 U.S. 936 (1980); *United States* v. *Louderman*, 576 F.2d 1383, 1387 (9th Cir.), cert. denied, 439 U.S. 896 (1978); *Abbott* v. *United States*, 239 F.2d 310, 314 (5th Cir. 1956); *United States* v. *Procter & Gamble Co.*, 47 F. Supp. 676 (D. Mass. 1942)).

An individual or firm reputation is also an intangible asset with a monetary value. See, *e.g.*, *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974); *Marcone* v. *Penthouse Int'l Magazine for Men*, 754 F.2d 1072, 1079-1080 (3d Cir.), cert. denied, 474 U.S. 864 (1985); *Braun* v. *Flynt*, 726 F.2d 245, 250-251 (5th Cir.), cert. denied,

469 U.S. 883 (1984); *Sauerhoff* v. *Hearst Corp.*, 538 F.2d 588, 590 (4th Cir. 1976); *Lewis* v. *Elliott*, 628 F. Supp. 512, 523 (D.D.C. 1986); *Sharon* v. *Time, Inc.*, 599 F. Supp. 538, 586 (S.D.N.Y. 1984). That is particularly true of a reputation that gives added value to a firm's commercial product—a reputation that the firm is entitled to exploit, convey, and protect from others. Indeed, a reputation for integrity and reliability is an integral part of good will, an asset that often has a specific cash value (see, *e.g.*, *Stewart & Stevenson Services, Inc.* v. *Pickard*, 749 F.2d 635, 649 (11th Cir. 1984); *North Clackamas Community Hosp.* v. *Harris*, 664 F.2d 701, 706 (9th Cir. 1980); *Levitt Corp.* v. *Levitt*, 593 F.2d 463, 468 (2d Cir. 1979); *General Television, Inc.* v. *United States*, 449 F. Supp. 609, 611 (D. Minn. 1978), aff'd, 598 F.2d 1148 (8th Cir. 1979)) that may be purchased and reflected on a balance sheet (see, *e.g.*, *Lambert* v. *Fisherman's Dock Co-op, Inc.*, 61 N.J. 596, 297 A.2d 566 (1972)).

c. Petitioners plainly threatened harm to these property rights of the Journal. The *Heard* column was prepared by Journal employees (both Winans and other, honest reporters (see Pet. App. 42a)), using the Journal's resources, for the Journal's benefit; indeed, the Journal's business was the preparation and dissemination (for profit) of the *Heard* column, along with many other features of the newspaper. The Journal had an undisputed right to prohibit other persons from making undesired uses of its proprietary information about the contents and timing of the *Heard* column. The convictions in this case were based on explicit findings that petitioners invaded that property right, fraudulently misappropriating proprietary information about the *Heard* column. Their invasion [redacted] "'wrong[ed the Journal in its] property rights by dishonest methods or schemes'" (*McNally*, slip op. 8 (citation omitted)).

This was more than an abstract interference with the Journal's property: petitioners used the misappropriated information in a way that threatened to diminish the

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value of the *Heard* column as a continuing feature that attracted readers to the Journal. The *Heard* column is "a daily market gossip feature which highlights a stock or group of stocks" (Pet. App. 35a). It was of great interest to Journal readers (and therefore of great value to the Journal) because it provided "both negative and positive information about its featured stocks" (*ibid.*) and often "[took] a point of view with respect to investment in the stocks that it reviews" (*ibid.*).[2] But as both courts below found, "the predictability of the columns' market impact depended in large part on the *perceived* quality and integrity of the columns" (Pet. App. 7a (emphasis added), citing Pet. App. 44a n.4). And the Journal had every reason to assume that the public's interest in the column, and hence the column's value to the Journal, would be sharply diminished if the public were to learn that Journal employees and their co-conspirators were misusing their knowledge of the contents and timing of columns to beat the public to the trading floor, or come to believe that an author of the *Heard* column might distort or time the column to fit his own investment strategies.[3] That is why the Journal exercised (see J.A. 40-43) its property right to control the use of information about the *Heard* column (and other Journal columns) by Journal employees. The dis-

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[2] It is apparent from the record here that the *Heard* column was a significant source of information for Journal readers: both courts below found that the column has a predictable and often dramatic impact on the prices of the securities that it discusses (Pet. App. 19a n.9, 35a-36a). And the likelihood that the column would move the market in turn plainly made it essential reading for many in the investment community. On the other hand, the district court found that "if false or slanted articles were published, the column's readers would very likely lose confidence in the column and cease to rely on it" (Pet. App. 44 & n.4). Of course, such damage would occur not only if the column were slanted in fact, but also if readers perceived that, because of conflicting interests, it might be.

[3] Petitioners have argued throughout this case that Winans maintained "the journalistic purity of the column" (Pet. App. 44a n.4). The district court did not wholly believe them (see *id.* at

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trict court thus correctly found that the Journal viewed information about the contents and timing of its columns as its property (Pet. App. 36a), that Winans knew that his actions violated the Journal's policies restricting the use of this property (*id.* at 37a)—and that petitioners' conduct accordingly amounted to a "fraudulent misappropriation or theft of the [Journal's] property" (*id.* at 64a).[4]

The effect of petitioners' actions on the *Heard* column also illustrates how, more generally, "the fraudulent taking and misuse of the confidential information stolen from the [Journal] placed * * * in jeopardy probably [the Journal's] most valuable asset—its reputation for fairness and integrity" (Pet. App. 64a). This reputation (for, among other things, not letting staff members do what Winans did) was no mere abstraction: it gave every financial column and story more importance to potential readers, more market impact,[5] and more value

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44a-45a), but the argument in any event misses the point: Journal *readers* would have no reason to believe that a reporter could and would "maintain[] a stance of journalistic purity when the reporter is engaged in a decidedly unpure venture" (*id.* at 44a). By giving themselves a conflicting interest in the *Heard* column, petitioners obviously endangered its reputation for reliability and hence its value.

[4] Indeed, at least as between the Journal and Winans, the Journal was entitled to the profits Winans obtained through the misappropriation of the *Heard* column: "If an agent receives anything as a result of his violation of a duty of loyalty to the principal, he is subject to a liability to deliver it, its value, or its proceeds, to the principal." Restatement (Second) of Agency § 403 (1958). Since this Court's decision in *McNally*, at least one court of appeals has held that an employee's receipt of secret profits supports a mail fraud charge. *United States* v. *Fagan*, No. 86-2284 (5th Cir. June 30, 1987), slip op. 16 & n.4, 18-19 n.6.

[5] As we have noted (note 2, *supra*), a story's expected market impact would obviously increase readers' interest in it and therefore its value to the Journal. Market impact, which depended on the Journal's reputation, is also what made petitioners' scheme work. Petitioners were thus exploiting, for their own commercial purposes, the very reputation they were endangering, which had concrete commercial value to the Journal.

to the Journal than it would have if the Journal were suspected of letting its writers have conflicting interests in their stories, or if the Journal were thought to let its reporters beat readers to the punch. Petitioners, by simultaneously using, threatening, and diminishing the Journal's reputation, "thereby defraud[ed the Journal] 'as surely as if they took its money'" (Pet. App. 18a (citation omitted)).

In sum, unlike *McNally*, this case does not involve merely an abstract expectation on the part of the public at large. Petitioners here took, used, and damaged specific (albeit intangible) property belonging to an identifiable victim: information about the *Heard* column that the Journal was entitled to prohibit others from misusing, so as to preserve, inter alia, the value of the column as an attraction for readers. And petitioners' conduct threatened to have a destructive effect on the Journal's general reputation. These property rights existed independently of the Journal's interest in the loyalty of its employees.[6]

2. *McNally* is entirely inapposite to petitioners' convictions under Section 10(b) and Rule 10b-5. The theory of those convictions was that "'one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) and Rule 10b-5'" (Pet. App. 53a (citation omitted)). As we have explained (Gov't Br. 42-45), such a use of fraudulently acquired information in securities trading injures the integrity of the market. This "misappropriation theory" of liability—which has been accepted by four Justices of this Court, has been endorsed

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[6] Although this was not the basis of the prosecution here (see Gov't Br. 32 n.32), an employee's breach of duty that deprives his employer of bargained-for services may well defraud the employer of money, since the employer in such a case "is not getting what he paid for" (*McNally*, slip op. 17 n.10 (Stevens, J., dissenting)). See also *United States* v. *Fagan*, slip op. 15, (post-*McNally* holding that an employee's receipt of kickbacks deprived the employer of property, because it deprived the employer of the opportunity to "capture[] for itself the large sums that [the employee] was secreting").

by committees of Congress, and is firmly settled in the Second Circuit—simply does not involve the question whether there has been an injury to "property" within the meaning of *McNally*.

In holding that Section 1341 protects only property rights, the Court in *McNally* relied on the language (see slip op. 6-8, 9), history (see *id.* at 6), and purposes (see *id.* at 5-6) of the mail fraud statute. But all of these considerations suggest the *absence* of any such limitation under Section 10(b) and Rule 10b-5. First, in contrast to Section 1341, the securities fraud provisions make no reference to property; to the contrary, Section 10(b) prohibits the use "in connection with the purchase or sale of any security" of "any manipulative or deceptive device or contrivance" in contravention of the Commission's rules, while Rule 10b-5 prohibits "any act, practice or course of business which operates * * * as a fraud or deceit upon any person." Those provisions "establish[] higher standards of conduct in the securities industry" than those mandated by the common law, and the Court accordingly has "eschewed rigid common-law barriers in construing the securities laws." *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 310 (1985). See *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 388-389 (1983).

Second, the stated purposes of Section 10(b) are quite different from those of Section 1341, and the difference explains why the former contains no reference to deprivations of "money or property." While Section 1341 was enacted to "protect[] property rights" (*McNally*, slip op. 5), the Exchange Act was designed to "insure the maintenance of fair and honest markets in [securities] transactions." 15 U.S.C. 78b. See H.R. Conf. Rep. 94-229, 94th Cong., 1st Sess. 91-92 (1975) ("the basic goals" of the Exchange Act are "to assure that dealing in securities is fair and without undue preferences or advantages among investors"). Section 10(b), in turn, has the specific purpose of eliminating from the securities markets all "manipulative and deceptive practices." S. Rep. 792, 73d Cong., 2d Sess. 6 (1934). See *Ernst & Ernst* v.

Hochfelder, 425 U.S. 185, 203 (1976); *Stock Exchange Regulation: Hearing on H.R. 7852 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934) (statement of Thomas G. Corcoran). As we have explained (Gov't Br. 40-45), trading on fraudulently acquired information is just such a deceptive practice or "cunning device" (*Hochfelder*, 425 U.S. at 203 (brackets omitted)).[7] Regardless of whether misappropriated information is deemed to be "property," its use in trading corrupts honest markets and discourages investors from trading (see Gov't Br. 43-45). Cf. *McNally*, slip op. 8-9 n.8 (noting that the policies served by another specialized fraud statute, 18 U.S.C. 371, mandate the conclusion that the term "to defraud" in that statute is not limited to the deprivation of property rights).

Finally, there is no reason to fear that failure to limit Section 10(b) to injury to property would lead either to open-ended criminal liability or to federal involvement in the regulation of matters of state concern (cf. *McNally*, slip op. 9). Liability under Section 10(b) and Rule 10b-5 is bounded by the requirement that the fraud have occurred in connection with the purchase or sale of a security. And more than half a century ago Congress declared that transactions in securities markets are "affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters relating thereto" (15 U.S.C. 78b); indeed, conduct that tends to drive investors out of the market threatens "our nation's economic growth and stability" (H.R. Rep. 98-355, 98th Cong., 1st Sess. 2 (1983); see Gov't Br. 44). There is no reason to doubt that Congress intended in Section 10(b) to prohibit conduct like the "decidely unpure venture" (Pet. App. 44a) of which petitioners stand convicted.

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[7] While the legislative history of Section 1341 is "sparse" (*McNally*, slip op. 6), a congressional committee report that the Court has found relevant in construing Section 10(b) (see Gov't Br. 41) expressly endorsed the proposition that "deceitful misappropriation of confidential information by a fiduciary" violates Section 10(b) and Rule 10b-5.

CONCLUSION

For the foregoing reasons and the reasons stated in our opening brief, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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REPLY BRIEF FOR PETITIONERS

Petitioners David Carpenter, Kenneth P. Felis and R. Foster Winans respectfully submit this reply both to the government's brief on the merits and to the government's supplemental brief, which addressed the significance to this case of *McNally v. United States*, 107 S. Ct. 2875 (1987).

ARGUMENT

POINT I

McNALLY CONFIRMS THAT THE MAIL AND WIRE FRAUD STATUTES DO NOT EXTEND TO SIMPLE BREACHES OF PRIVATE WORKRULES, INTANGIBLE INJURIES, AND INCIDENTAL MAILINGS AND WIRINGS

In our main brief, we enumerated three independent reasons why petitioners' convictions under the mail and wire fraud statutes cannot stand. Pet. Br. at 31–46.[1] First, such convictions cannot be premised on a breach of internal corporate workrules. Second, the mail and wire fraud statutes do not apply to the intangible interests on which the courts below based their verdicts. Third, the charged mailings and wirings — involving the routine printing of The Wall Street Journal (the "Journal") and its subsequent normal distribution — were neither caused by petitioners nor made for the purpose of executing their scheme, as the statutes require. Each of these reasons is a separate, distinct and compelling ground for reversal. Each demonstrates that the government and the courts below unjustifiably expanded the mail and wire fraud statutes beyond all reason and principle.

We submit that nothing in the government's brief on the merits detracts from these three reasons for reversal. Notwithstanding the fact that the government expressly conceded below, and the district court expressly found, that criminal liability here was "premised on [a violation of]

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1. Citations to petitioners' brief are denoted as "Pet. Br.;" citations to the government's brief in opposition and to its supplemental brief are denoted as "Gov't Br." and "Gov't Supp. Br.," respectively. Other citations are in the form denoted in our main brief.

corporate internal policy," 612 F. Supp. at 843; 59a — specifically, a breach of the Journal's conflicts of interest rules — the government's main brief attempts to recast this case as one of "deliberate failure by one party in a relationship of trust and confidence to correct a misimpression held by the other party. . . ." Gov't Br. at 27. Quite aside from the fact that this novel interpretation was neither charged in the indictment, argued below, nor adopted by either of the lower courts, it amounts to little more than wordplay, for any breach of an employer's internal workrules occurring over time can be recast in those terms. Thus, in arguing that Winans committed a federal crime by "continuing [to] *pose* as a loyal employee," Gov't Br. at 26 (emphasis in original), and "fail[ing] to disclose his rejection of [the Journal's] understandings," Gov't Br. at 17, the government advances a boundless theory of mail and wire fraud liability which criminalizes any undisclosed workrule violation by an employee, even if the employer has not expressly imposed any such duty of disclosure. Gov't Br. at 17 n.12.

Subsequent to the filing of the government's brief, this Court decided *McNally v. United States*, 107 S. Ct. 2875 (1987). That case further confirms that the decisions below were demonstrably wrong. *McNally* makes clear that the statutory proscription against "schemes to defraud" extends only to conduct intended to cause deprivation of money or property; it does not criminalize breaches of employee duty that deprive an employer of his "intangible rights," such as his "right" to his employee's "loyalty."

Here, the courts below, lacking the guidance of *McNally*, held that the "seemingly limitless"[2] mail and wire fraud statutes criminalize both employee disloyalty and nondisclosure which contemplates harm to an employer's

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2. 612 F. Supp. at 843; 60a.

intangible interests. 612 F. Supp. at 844–45; 63a–64a.[3] The courts below concluded that an illegal scheme to defraud was established by findings that (1) Winans' disclosures and non-disclosures violated a "practice" of confidentiality at the Journal, which "inexorably" demonstrated that he breached a fiduciary duty, *id.* at 844; 62a, and that (2) "such unethical conduct" contemplated injury to the Journal's "reputation for journalistic integrity." *Id.* at 845; 63a.[4] In light of *McNally*, these findings were plainly insufficient and warrant reversal.

McNally rejected such an overexpansive view of mail and wire fraud and reaffirmed that these statutes are limited "to protect[ing] the people from schemes to deprive them of their money or property."[5] Because the courts below did not find, or even look for, any "scheme" by petitioners "aimed at causing deprivation of money or property,"[6] there is no legally sufficient basis to impose criminal sanctions upon petitioners under the mail and wire fraud statutes.

In its post–*McNally* supplemental brief, the government suggests two theories to try to satisfy (after–the–fact) the requirement of intended deprivation of money or property. The government summarizes these two theories as follows:

> [First], [p]etitioners here took, used, and damaged specific (albeit intangible) property belonging to an identifiable victim: information

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3. *See also* 791 F.2d at 1035; 24a.

4. Pushing one step further, the courts below held that non-employees Carpenter and Felis were likewise criminally liable for benefitting from Winans' breaches, even though they were either only "generally aware" of the Journal's rules or not aware of them at all. Pet. Br. at 32. This flatly violates this Court's holding in *Ingram v. United States*, 360 U.S. 672 (1959).

5. *McNally*, 107 S. Ct. at 2879.

6. *Id.* at 2880.

> about the *Heard* column that the Journal was entitled to prohibit others from misusing, so as to preserve, inter alia, the value of the column as an attraction for readers. And [second] petitioners' conduct threatened to have a destructive effect on the Journal's general reputation. These property rights existed independently of the Journal's interest in the loyalty of its employees.

Gov't Supp. Br. at 8. As to the first theory, it is perhaps enough to note that it was never relied on below; indeed, the notion that the Heard column's "attractiveness" to readers (an amorphous form of "property" at best) was somehow fraudulently stolen by petitioners was never relied on by the government at any stage of these proceedings until its supplemental brief to this Court.[7]

More generally, the government's assumption — that "information about the Heard column" (*i.e.*, its timing and tenor),[8] as opposed to the columns themselves, is, in fact, the "property" of the Journal or its parent, Dow Jones & Co., Inc. — is questionable at best. The only proof of Dow Jones' "ownership" of knowledge of the timing and tenor of forthcoming articles is a statement in the Dow Jones conflicts of interest policy that such information is "deemed" by Dow Jones to be its property.[9] Such unilateral "deeming" made in one clause hidden deep within the company handbook does not,

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7. The *post hoc* and wholly irrelevant character of this argument is further evidenced by the fact that the Indictment in this case does not charge a scheme to deprive the Journal of either of these alleged forms of "property," but only a scheme "to obtain money." *See* Indictment, paragraphs 9, 40 and 43 (App. 3, 15 and 18).

8. All other information about the column, in particular the information used as the basis for the column, was public knowledge. 791 F.2d at 1037; 28a (Miner, J., dissenting); 612 F. Supp. at 830 n.2; 35a n.2.

9. App. 41.

in fact, make such information the property of Dow Jones. Moreover, as a matter of law, there is considerable doubt whether Dow Jones' copyright can fairly be held to extend to advance (and therefore unpublished) information about the timing and tenor of Heard columns.[10]

Beyond all this, the government's further contention that petitioners "deprived" the Journal of this "property" is flatly wrong. Petitioners' use or possession of such information in no way affected the Journal's ability to use it. At most, petitioners' conduct can be said to have interfered with the Journal's right to *exclusive* use of the information. However, such exclusivity of use of the information only has value *vis a vis* the Journal's competitors[11] and no disclosures to competitors were made in this case.[12]

The second prong of the government's deprivation of property analysis — threat to reputation — likewise misses the mark. For one thing, reputation is not generally regarded as property, and the government offers no principled basis to demonstrate why reputation should be considered "property" here, when it is not under other federal laws. This Court has recognized that reputation "is simply one of a number [of interests] which the State may protect against injury by virtue

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10. *See generally Harper & Row Publishers, Inc. v. Nation Enterprises*, 723 F.2d 195, 202 (2d Cir. 1983), *rev'd on other grounds*, 471 U.S. 539 (1985); *H.C. Wainwright & Co. v. Wall Street Transcript Corp.*, 418 F. Supp. 620, 624 (S.D.N.Y. 1976), *aff'd*, 558 F.2d 91 (2d Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978); *Time, Inc. v. Bernard Geis Assoc.*, 293 F. Supp. 130, 143 (S.D.N.Y. 1968).

11. *See, e.g., International News Service v. The Associated Press*, 248 U.S. 215, 240 (1918).

12. If petitioners' conduct had inflicted cognizable injury on the Journal's actual property, one would have expected the Journal to sue petitioners and their numerous alleged co-conspirators. No such suit was ever brought, nor did the Journal claim any disgorged profits.

of its tort law, providing a forum for vindication of those interests by means of damages actions," but is "neither 'liberty' nor 'property' guaranteed against state deprivation without due process of law."[13] As in *Paul v. Davis*, "the interest in reputation alone which [the government] seeks to vindicate in this action in federal court is quite different from the 'property' " cognizable under the mail and wire fraud statutes.[14]

Moreover, petitioners' conduct cannot be viewed as a scheme aimed at depriving the Journal of its reputation, since, as the government itself points out, the Journal's good reputation is the very thing that "made petitioners' scheme work."[15] Indeed, the district court found that petitioners intended that there be continued readership "confidence" in the Journal, and that such a result was "consistent with the[ir] goals."[16] 612

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13. *Paul v. Davis*, 424 U.S. 693, 712 (1976).

14. *Id.* at 711. Cases cited by the government attributing monetary value to intangibles in the contexts of particular competitive industries involving thefts of trade secrets, defamation, and sales of good will are inapposite to establish the *general* "proprietary interest" in reputation urged by the government here, nor do they remotely apply to the facts of this case. Defamation actions, for example, allow recovery to redress an injury to reputation only when it can be measured in terms of quantifiable damage to another, tangible interest (such as loss of employment). *See, e.g., Emory v. Peeler*, 756 F.2d 1547, 1554 (11th Cir. 1985); *Pirre v. Printing Developments, Inc.*, 468 F. Supp. 1028, 1037 (S.D.N.Y.), *aff'd*, 614 F.2d 1290 (2d Cir. 1979).

15. Gov't Supp. Br. at 7 n.5.

16. While the district court went on to hold that the loss to the Journal's reputation that (supposedly) would be incident to exposure of petitioners' scheme satisfied the "contemplated harm" requirement of the statute, 612 F. Supp. at 845; 63a, this confuses an element of the crime itself (namely, an intentional scheme to fraudulently deprive a victim of his money or property) with an effect of its exposure (namely, bad publicity for all concerned). The Second Circuit has itself now apparently recognized this error. *See United States v. Starr*, 816 F.2d 94, 99–101 (2d Cir. 1987) (fact

F. Supp. at 835 n.4; 44a n.4.[17]

McNally also puts in sharper focus the inadequacy of the mails and interstate wires alleged in this case. If, as the government now contends, the "property" in question was the Journal's publication schedule, it is clear that any intended "deprivation" of such property (assuming *arguendo* that such a "deprivation" was cognizable as fraud under *McNally*) was completed before the time of the mailings and wirings. Petitioners thus could not have "caused" the mailings and the wirings for the "purpose of executing" the already completed fraud.[18]

In sum, the federal mail and wire fraud statutes do not exist to regulate intracorporate affairs or redress intracorporate misconduct by criminalizing a newspaper columnist's failure to comply with the corporate policies established by his employer. The imposition of criminal sanctions upon petitioners under the facts of this case exceeds the historical limits of the mail and wire fraud statutes recently reaffirmed by this

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that exposure of defendants' scheme led to "defeated expectations" on the part of its victims did not satisfy requirement of contemplated harm).

17. With respect to the government's final contention that "an employee's breach of duty that deprives an employer of bargained-for services may well defraud the employer of money, since the employer in such a case 'is not getting what he paid for,' " it is sufficient to note the government's concession that petitioners were not prosecuted under such a theory. Gov't Supp. Br. at 8 n.6 (quoting *McNally*, 107 S. Ct. at 2890 n.10 (Stevens, J., dissenting)). Moreover, such a theory would stand *McNally* on its head by converting, without limitation, any breach of contract into a mail fraud. *See Ingber v. Enzor*, 664 F. Supp. 814 (S.D.N.Y. 1987) (recognizing that "payment of . . . [a] . . . salary, a routine and budgeted expenditure, does not constitute a loss of money or property as contemplated by *McNally* and the mail fraud statute").

18. *See United States v. Maze*, 414 U.S. 395 (1974); *United States v. Kwiat*, 817 F.2d 440 (7th Cir. 1987); *United States v. Taylor*, 789 F.2d 618 (8th Cir. 1986); *United States v. Iorizzo*, 786 F.2d 52 (2d Cir. 1986).

Court, and "involves the Federal Government in setting standards of disclosure and good [reputation]" for corporate employers.[19] Because neither Congress nor this Court has "spoken in clear and definite language"[20] to proscribe petitioners' activities, their convictions under the mail and wire fraud statutes should be reversed.

POINT II

NOTHING IN EXISTING FEDERAL SECURITIES LAW WARRANTS THE IMPOSITION OF CRIMINAL SANCTIONS AGAINST PETITIONERS

In our main brief, we argued that, just as petitioners' conduct did not fall within the vast reach of the mail and wire fraud statutes, similarly it did not fall within the somewhat more constricted confines of the federal securities laws, for it involved no breach of duty to a market participant. In response, the government, confronted now with *McNally*, goes so far as to argue that securities fraud is somehow broader than even mail or wire fraud and criminalizes any breach of any duty to anyone, as long as securities are somewhere involved. This novel theory would transform Rule 10b–5 into a law governing any number of relationships outside the securities markets by imposing liability for securities fraud where the party defrauded has no interest in the purchase, sale or value of the securities traded. This is simply not the law nor should it be.

In straining to establish petitioners' criminal liability for securities fraud based upon Winans' breach of duty to the Journal, the government loses sight of this Court's unambiguous declaration that "[n]ot 'all breaches of fiduciary

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19. *See McNally*, 107 S. Ct. at 2881.

20. *Id.*

duty in connection with a securities transaction' come within the ambit of Rule 10b–5."[21] The government's theory that securities trading becomes securities fraud upon a showing of *any* "breach of *any* duty to *anyone*"[22] completely contradicts "the principle set forth in *Chiarella* that only *some* persons, under *some* circumstances, will be barred from trading while in possession of material nonpublic information,"[23] and the "requirement" of *Chiarella*,[24] reaffirmed in *Dirks*, that "a *specific* [and relevant] relationship [must exist] between the shareholders and the individual trading on inside information."[25] The government's argument that a securities fraud conviction may be premised upon any incidental duty imposed by any third party "market observer"[26] which has no interest or involvement in the underlying securities transaction creates "a new and different theory of liability"[27] that ignores the limiting principles carefully established by this Court and reads the Exchange Act " 'more broadly than its language and statutory scheme reasonably permit.' "[28]

The government purports to find support for its extraordinarily expansive views in the so–called "misappropriation theory," which it interprets as warranting the prosecution of anyone who misappropriates information from anyone else as

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21. *Dirks v. SEC*, 463 U.S. 646, 654 (1983) (quoting *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 (1977)).

22. Gov't Br. at 39 (emphasis supplied); *see Chiarella v. United States*, 445 U.S. 222, 228–30 (1980).

23. *Dirks*, 463 U.S. at 657 (emphasis supplied).

24. *Chiarella*, 445 U.S. at 232–33.

25. *Dirks*, 463 U.S. at 655 (emphasis supplied).

26. Gov't Br. at 45.

27. *Chiarella*, 445 U.S. at 234.

28. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979) (quoting *SEC v. Sloan*, 436 U.S. 103, 116 (1978)); *see Chiarella*, 445 U.S. at 234.

long as the misappropriator thereafter uses the information in connection with the purchase or sale of securities. Gov't Br. at 37. As so interpreted, the "misappropriation theory" would violate not only *Chiarella* and *Dirks* but also common sense. Rather than reading the securities laws as laws designed to protect market participants against securities fraud, the government would read them as laws designed to protect anyone against any kind of fraud as long as there was some subsequent contact with a securities trade.

However, no fair reading of the lower court decisions that have adopted a "misappropriation theory" warrants the government's excessive claims. The "misappropriation theory" of securities fraud liability as heretofore applied does not encompass breaches of duty owing exclusively to third parties who are not market participants, and does not support the imposition of criminal sanctions against petitioners based upon Winans' alleged breach of duty to the Journal. Rather, the "fraud" established in every other case applying any kind of "misappropriation theory" involved a breach of duty ultimately owing to a person or entity having an interest in the purchase, sale or value of the securities being traded. In all of these cases, the breached duty found cognizable under the federal securities laws was the duty of confidentiality owed to securities market participants (acquiring companies contemplating tender offers) by entities (*i.e.*, printers, investment banks) whose corporate clients (those same securities market participants) had entrusted them with nonpublic securities–related information. An employee trading upon these client confidences may commit securities fraud under the "misappropriation theory," or any other theory, not because he has breached his employer's particular confidentiality policy, but because he has violated a duty of confidentiality owed to his employer's client, a participant in the very securities market transactions affected by the misappropriator's trades

and the entity which is thereby itself defrauded in its capacity as an investor.[29] Without any such underlying breach of duty to a market participant, the "misappropriation theory" does not criminalize Winans' intracorporate misconduct.

Having posited its illogical and extraordinarily expansive "misappropriation theory," the government purports to find support for it in judicial precedent, statutory language and history, and social policy; but its arguments in this regard cannot withstand scrutiny.

First, as to precedent, the government relies primarily on inferences from language in the various opinions in *Chiarella*.[30] However, *Chiarella* — unlike this case, but like all other "misappropriation" cases — involved a defendant employee who used confidential securities–related information entrusted by his employer's clients (market participants) to his employer, who had a fiduciary duty to safeguard that information. Concomitantly, the "misappropriation theory" of securities fraud liability presented to this Court in *Chiarella* proposed only that an employee's breach of "a duty of silence owed to the *acquiring companies* . . . that had entrusted confidential information to his employer . . . constituted 'a fraud or deceit' upon *those companies*" cognizable under the federal securities laws.[31] The validity of such a "misappropriation theory," in which a client, itself a market participant, is defrauded in connection with its own contemplated securities purchases, is simply irrelevant to this case, where there is no claim that any market participant was defrauded.[32]

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29. *See* Pet. Br. at 21 n.36.

30. Gov't Br. at 40.

31. *Chiarella*, 445 U.S. at 237–38 (Stevens, J., concurring) (emphasis supplied).

32. *See* Note, *Insider Trading and the Misappropriation Theory: Has the Second Circuit Gone Too Far?*, 61 St. John's L. Rev. 78, 100–12

Second, as to statutory language and history, the government's extraordinary suggestion[33] that the scheme to defraud language of Rule 10b–5 was somehow meant to be given a broader meaning than the scheme to defraud language of the mail and wire statutes, despite their common antecedent,[34] is wholly without support. Contrary to the government's claim that "*McNally* is entirely inapposite to petitioners' convictions under Section 10(b) and Rule 10b–5,"[35] which require only a vague "injury to the integrity of the market"[36] rather than an injury to property, the legislative history, though sparse, at least demonstrates that Rule 10b–5 was derived from section 17 of the Securities Act of 1933, which (following on the mail fraud statute) expressly contains the words "to obtain money or property."[37] As stated by Judge Friendly in *SEC v. Texas Gulf Sulphur Co.*:[38]

> Although the authority for the Rule comes from § 10(b) of the Securities and Exchange Act of 1934, the draftsmen turned their backs on that section and borrowed the words of § 17 of the Securities Act of 1933, simply broadening these to include frauds on the seller as well as the buyer.[39]

(1987).

33. Gov't Supp. Br. at 8–11.

34. False Pretenses Act of 1757, 2 Geo., ch. 24.

35. Gov't Supp. Br. at 8.

36. *Id.* at 9–10.

37. Elsewhere, the government concedes that Rule 10b–5 and section 17 are "nearly identical" and should be similarly construed. Gov't Br. at 38 n.36; *see Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212–13 n.32 (1976).

38. 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969).

39. *Id.* at 867.

The origin of the rule makes clear that the draftsmen were addressing a scheme to defraud an investor of money or securities, which of course is property; they were not addressing conduct toward a third party (*i.e.*, a newspaper) which was not buying or selling securities.[40]

The government's purported reliance on the legislative history of the Insider Trading Sanctions Act of 1984 (the "ITSA")[41] also misses the mark. The most that the legislative history of the ITSA suggests — assuming *arguendo* that its legislative history is suggestive of Congress's intent in 1934 — is an endorsement of the result in *United States v. Newman.*[42] Extension of the "misappropriation theory" beyond market participants, however, was not presented in *Newman*, which involved the defrauding of the *client* corporation in connection with the *client's* contemplated purchase of stock.[43] Indeed, a more recent legislative proposal defining insider trading by the Securities and Exchange Commission itself represents an implicit admission by the Commission that the law heretofore has not unambiguously covered Winans' conduct (as fair notice and due process require).[44]

Likewise, other recent legislative proposals in Congress have been accompanied by express acknowledgments of Congress's prior failure to address any form of the

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40. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 767 (1974) (Blackmun, J., dissenting).

41. Pub. L. No. 98-376, 98 Stat. 1264; *see* Gov't Br. at 49 n.53.

42. 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983).

43. *Id.* at 15.

44. *See* Securities and Exchange Commission, *Proposed Legislation, "The Insider Trading Act of 1987" And Memorandum of Support Submitted to the Subcommittee on Securities of the U.S. Senate* (Aug. 7, 1987).

"misappropriation theory," let alone the expansive form which the government proposes here. Thus, for example, the Explanatory Memorandum accompanying the D'Amato/ Riegle bill[45] notes that "the major linchpin on which many governmental insider trading cases are predicated today — the misappropriation theory — is itself a judicially–created construct, the parameters of which have never been addressed by either Congress or the Supreme Court"[46] and the current basis for which has "required tortured analyses of business, personal and other relationships in order to find [liability]."[47] The Memorandum adds that "[t]he *Winans* case is an example of this phenomenon, since the prosecution depended, at least in part, upon the fortuity of the adoption of a Code of Conduct by the *Wall Street Journal*, upon which a breach of duty by Mr. Winans was predicated . . . [rather than] on statutory principles. . . ."[48]

Third, as to policy, the government's attempt to support its expanded "misappropriation theory" by portraying it as necessary to fill "a large and illogical loophole in the securities laws"[49] is neither accurate nor relevant. It is inaccurate because, assuming the availability of Rule 14e–3, there is no gap which would be filled by the government's expansion of the "misappropriation theory," except the inability to sustain

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45. *See* Explanatory Memorandum accompanying introduction of S. 1380, the proposed "Insider Trading Proscriptions Act of 1987," introduced by Senators D'Amato and Riegle on June 17, 1987.

46. *Id.* at 2.

47. *Id.* at 7 n.7. The Explanatory Memorandum stresses that "as a matter of fundamental fairness to those who seek to conform their conduct to the law," the "Congress should determine whether the [misappropriation] theory has sound policy bases, articulate those bases and establish guidelines for application of the theory." *Id.* at 2.

48. *Id.* at 2–3.

49. Gov't Br. at 41.

this conviction on appeal.[50] It is irrelevant because it is simply not the function of courts to fill in "gaps" in the statutory definition of crimes.[51] Rather, it is settled beyond peradventure that courts are not empowered to create "constructive offenses" to punish criminal defendants whose cases are not shown to be "plainly within the statute" upon which they are convicted.[52]

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50. Ivan Boesky and other defendants whose prosecutions are cited by the government, Gov't Br. at 42 n.43, were subject to liability under Rule 14e–3. *SEC v. Siegel*, No. 87 Civ. 0963 (RO) (S.D.N.Y. Feb. 13, 1987); *SEC v. Boesky*, No. 86 Civ. 8767 (RO) (S.D.N.Y. Nov. 14, 1986); *SEC v. Levine*, No. 86 Civ. 3726 (RO) (S.D.N.Y. June 5, 1986). In addition, the government, without resort to any "misappropriation theory," had no difficulty in prosecuting them on a variety of traditional charges, such as tax evasion, *see United States v. Siegel*, No. 87 Crim. 378 (RJW) (S.D.N.Y. Feb. 13, 1987); *United States v. Levine*, No. 86 Crim. 519 (GLG) (S.D.N.Y. June 5, 1986), and they were further subject to potential state law liability, which the government, in its overweening desire to federalize the entire law of corporate behavior, consistently ignores. They might also have violated section 10(b) if the Court answers affirmatively the question left open in *Chiarella* and concludes that they defrauded acquiring corporations in connection with *such* corporations' contemplated purchases of target company stock. The government's suggestion that, unless its expanded formulation of the "misappropriation theory" is accepted, law clerks will freely be able to trade on advance knowledge of their judges' securities–impacting decisions, Gov't Br. at 42 n.44, simply ignores the "temporary insider" prohibitions set forth in footnote 14 of *Dirks*. 463 U.S. at 655 n.14. Outsiders such as underwriters, accountants, lawyers or corporate consultants become temporary insiders because of their confidential relationship to the corporation and access to inside information. By analogy, persons who obtain access to confidential information by virtue of their public positions may similarly become temporary insiders with duties to market participants.

51. As this Court noted in *Dirks*, "in a statutory area of the law such as securities regulation, where legal principles of general application must be applied . . . behavior that may fall below ethical standards of conduct" is not always illegal. 463 U.S. at 661 n.21.

52. *See, e.g., McNally*, 107 S. Ct. at 2882.

The government goes further still and suggests that Rule 10b–5 must be read to embrace petitioners' conduct because of the general policy of the Exchange Act to promote "fairness" in the marketplace. This, of course, is just one more attempt to exhume the parity–of–information theory buried in *Chiarella*.[53] More basically, we submit that the general purpose of the Exchange Act to " 'insure the maintenance of fair and honest markets' "[54] does not suffice to criminalize anything the government considers unfair or dishonest any more than does the general purpose of the mail fraud statute to promote honesty in the postal system.[55]

A policy of "fairness," moreover, simply does not support a rule under which trading by Winans is criminal when identical trading by his employer, Dow Jones, would not be. While the government attempts to avoid the obvious incongruity with the suggestion that such trading by Dow Jones may have been prosecuted under a different theory, the two cases which it cites, *SEC v. Blavin*[56] and *Zweig v. Hearst Corp.*,[57]

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53. 445 U.S. at 233, 235 n.20.

54. Gov't Br. at 35 (quoting 15 U.S.C. § 78b (1982)).

55. While the government seems to recognize that section 10(b) gives the *Commission* authority to adopt rules to promote the public interest or protect investors, Gov't Br. at 43, it fails to appreciate that this statute does not and cannot give the *courts* any such legislative authority. Nor, for that matter, does it give private employers the legislative authority to criminalize employee conduct.

56. 557 F. Supp. 1304 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985). Unlike this case, *Blavin* involved an "investment advisor" who had a specific federally recognized fiduciary relationship with his clients arising under the Investment Advisors Act of 1940. 557 F. Supp. at 1309; *See Aaron v. SEC*, 446 U.S. 680, 693–94 (1980); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 192–93 (1963).

57. 594 F.2d 1261 (9th Cir. 1979). *Zweig*, like this case, did involve a newspaper reporter who was not an investment adviser. 594 F.2d at 1262. The case, however, involved affirmative misrepresentations and, in its broader implications, has been uniformly criticized in subsequent Ninth

are readily distinguishable. Moreover, we note, had any alternative theory of prosecution been available, the government would hardly have been expected to proceed *solely*, in a matter of "first impression," 791 F.2d at 1027; 8a, upon the expanded formulation of the "misappropriation theory."

Noteworthy too in this broad "policy" argument by the government is its implicit abandonment of the theories relied upon below. Instead of defending the lower courts' reliance upon reputational injury as a basis for the imposition of criminal liability under the securities laws, the government proposes new findings of "fact" on appeal to this Court, and argues that petitioners' conduct "damage[d] . . . the 'public interest,' "[58] was " 'unfair and inconsistent with the investing public's legitimate expectation of honest and fair securities markets . . .,' "[59] and "inflicted a wound on the market and all of the participants in it."[60] In addition to this implicit abandonment of the reputational harm theory as a basis for securities fraud liability, the government's suggestion that the "unfairness" of petitioners' trading brings their conduct within the ambit of section 10(b) reflects, as noted, a fundamental misconception about the role of the judiciary in enforcing the federal securities laws. To sustain petitioners' securities fraud convictions based upon undefined subjective standards such as "unfairness" would require this Court to read new language

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Circuit cases and legal commentary. *See, e.g., Feldman v. Simkins Industries, Inc.*, 492 F. Supp. 839, 846 (N.D. Cal. 1980)("[a]ssuming for purposes of this discussion the continuing validity of *Zweig* notwithstanding *Chiarella*, it is a case of active market manipulation and conflict of interest, not merely nondisclosure"), *aff'd*, 679 F.2d 1299, 1304 (9th Cir. 1982)(also questioning continuing validity of *Zweig*). *See* Note, *The Inadequacy of Rule 10b–5 to Address Outside Trading by Reporters*, 38 Stan. L. Rev. 1549, 1558–59 (1986).

58. Gov't Br. at 43.

59. *Id.* at 44 (quoting H.R. Rep. 98–355, at 5).

60. *Id.* at 45.

into the securities laws and impose a test of conduct which provides no genuine guidance.[61] The existing statutory scheme of federal securities regulation neither authorizes the criminalization of petitioners' conduct based on its perceived "unfairness," nor otherwise warrants the affirmance of petitioners' convictions.

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61. These dual infirmities were recently condemned by this Court in *Tanner v. United States*, 107 S. Ct. 2739, 2752–53 (1987). In like manner, the government's reliance on the broad "in connection with" language of the statute, Gov't Br. at 37, is misplaced. This patently ambiguous phrase must necessarily be construed consistently with the language and overall purpose of the statute — which, as we argue, is to protect investors and other market participants from being defrauded. To interpret it instead (as the government does) in isolation, as a roving warrant to criminalize any "unfair" activity that bears any incidental connection, however remote, to the purchase or sale of securities is to deprive the term of its logical meaning and context.

CONCLUSION

For the reasons set forth above and in our main brief, the judgment of the Court of Appeals for the Second Circuit should be reversed with instructions to dismiss the indictment.

Dated: September 30, 1987

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No. 86-422

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE REPORTERS COMMITTEE FOR FREEDOM OF THE PRESS, THE NATIONAL ASSOCIATION OF BROADCASTERS, THE NEWSLETTER ASSOCIATION, THE NEW YORK FINANCIAL WRITERS ASSOCIATION, THE MEDIA INSTITUTE, THE NEWSPAPER GUILD, THE RADIO-TELEVISION NEWS DIRECTORS ASSOCIATION, THE AMERICAN SOCIETY OF MAGAZINE EDITORS, THE SOCIETY OF AMERICAN BUSINESS EDITORS AND WRITERS, AND THE ASSOCIATED PRESS MANAGING EDITORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

Amici Curiae will address the following questions:

1. Whether a reporter for a newspaper can be prosecuted under the federal securities laws even though the reporter, as a pure market "outsider," owed no fiduciary duty to any market participant, did not trade on the basis of any "inside" corporate information, and did not injure any market participant.

2. Whether Rule 10b-5 should be construed narrowly to avoid imposing vague disclosure requirements on reporters which would interfere with the editorial processes of the print and broadcast media protected by the First Amendment.

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BRIEF OF THE REPORTERS COMMITTEE FOR FREEDOM OF THE PRESS, THE NATIONAL ASSOCIATION OF BROADCASTERS, THE NEWSLETTER ASSOCIATION, THE NEW YORK FINANCIAL WRITERS ASSOCIATION, THE MEDIA INSTITUTE, THE NEWSPAPER GUILD, THE RADIO-TELEVISION NEWS DIRECTORS ASSOCIATION, THE AMERICAN SOCIETY OF MAGAZINE EDITORS, THE SOCIETY OF AMERICAN BUSINESS EDITORS AND WRITERS, AND THE ASSOCIATED PRESS MANAGING EDITORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICI CURIAE*

The Reporters Committee for Freedom of the Press ("Reporters Committee") is a voluntary association of reporters and news editors from the print and broadcast media. It serves as a legal defense and research fund dedicated to protecting the freedom of information rights and editorial freedom of the press guaranteed by the First Amendment. Since its founding in 1970, the Reporters Committee has taken an active role in virtually every major case concerning press freedoms before the United States Supreme Court.

The National Association of Broadcasters ("NAB"), organized in 1922, is a nonprofit, incorporated association of more than 4,800 radio stations, 950 television stations, and the major commercial broadcast networks. One of NAB's primary concerns is maintaining the vitality of the First Amendment guarantee of freedom of the press.

The New York Financial Writers Association is made up of over 350 reporters and editors in the New York metropolitan area who are associated with national and local print and electronic media. Founded in 1938, the Association is dedicated to upholding the professional standards of business and financial journalists and encouraging education in this specialized field.

The Newspaper Guild is a trade union representing some 40,000 employees of newspapers, magazines, wire services and related enterprises in the United States, Canada and Puerto Rico. It has been actively involved in protecting the First Amendment rights of its members and all Americans.

The Radio-Television News Directors Association is a professional association of electronic journalists. The Association has over 2,500 members who gather, edit and disseminate news and other public affairs information carried by the national networks, local radio and tele-

vision broadcast stations and cable television systems throughout the nation.

The American Society of Magazine Editors has 450 members who are chief and senior editors of consumer, trade and farm magazines across the United States. The Media Institute is a nonprofit research organization which has published numerous reports on foreign and domestic communications policy and studies on broadcast coverage of economic news. The Newsletter Association is an international trade association of 850 publishers of 2,500 newsletters and other specialized services, which provide financial and other types of information.

The Society of American Business Editors and Writers is made up of more than three hundred business editors and writers of newspapers, periodicals, business journals, and radio and television programs across the nation. The Society was founded in 1962 and exists to promote the development of business news reporting and the highest professional standards of economic journalism.

The Associated Press Managing Editors include more than 600 editors of newspaper members of the Associated Press, which gathers news worldwide for dissemination to 1,350 newspapers and 3,300 broadcast stations in the United States.

Amici's membership includes reporters and editors from the field of financial journalism. Their professional interests are directly affected by the theory of the government's prosecution in this case, which asserts that Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, provide a permissible vehicle for enforcing vague and undefined duties of journalists to disclose to their editors and publishers any use of their employer's confidential information that may have some effect on a securities transaction which benefits the reporter. Put another way, the prosecution in this case at-

tempts to criminalize journalistic codes of ethics and, by using the employment relationship to define and establish a crime, to intrude improperly on the editorial process. *Amici* recognize that the government's prosecution of a pure market "outsider" does not uniquely disadvantage the interests of the press and broadcast media. The implications of this decision extend far beyond its impact on the editorial process. Nevertheless, the decision below, which grants the federal government enforcement power over alleged breaches of journalistic codes of ethics, provides the SEC with extensive authority to investigate and regulate the internal processes of the press. The potential for abuse of this power is a matter of substantial and legitimate concern to *amici*.

Amici are thus filing this brief to assist the Court by informing it of the broader concerns that are implicated by this particular prosecution.[1] *Amici* wish to emphasize, however, that they do not condone petitioner Winans' actions.

STATEMENT

A divided panel of the United States Court of Appeals for the Second Circuit has affirmed the conviction under the securities laws of a newspaper reporter who the government concedes had no fiduciary duty to any market participant and thus was a pure "outsider." Pet. App. 1a-29a. The court of appeals nonetheless held that Section 10(b) of the Securities Exchange Act, and Rule 10b-5 promulgated thereunder, were violated by the reporter when he "breached a duty of confidentiality to his employer by misappropriating from the [employer] confidential prepublication information, regarding the timing and content of certain newspaper columns" and used that information in purchasing and selling securities. Pet. App. 10a.

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[1] Pursuant to Rule 36 of the Rules of this Court, the parties have consented to the filing of this brief. Copies of those letters have been filed with the Clerk of the Court.

The case centers on the actions of petitioner Winans,[2] who from August 1982 to March 1984 authored the "Heard on the Street" ("Heard") column for the *Wall Street Journal* ("*Journal*"). The column consists of market gossip regarding notable volumes of trading in specific securities or price movements of various stocks. The Heard column did not rely upon or release any "inside" or confidential information, nor did the column purport to provide investment advice. However, the district court found that publication of the column had some unquantifiable impact on the prices of the securities that were the subject of a Heard column. Pet. App. 35a-36a.

Beginning in October 1983, petitioner Winans entered into an agreement with stockbroker Peter Brandt of Kidder, Peabody & Co., Inc. ("Kidder, Peabody"). Winans agreed to disclose the general tenor of comments—favorable or unfavorable—about specific securities and the probable publication date of upcoming columns in order to permit Brandt to trade in anticipation of the column's likely effect on the market price of the subject stocks. Winans never falsified or otherwise shaded the content or tenor of the column.[3] The agreement provided that profits, if any, were to be split between Winans, Brandt and petitioner Felis, another stockbroker at Kidder, Peabody, who assisted Brandt by executing many of the trades through his personal account.[4] Petitioners traded

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[2] The facts of the case are set forth in detail in the opinion of the district court, Pet. App. 33a-73a, and summarized by the court of appeals, Pet. App. 5a-7a. Because the securities fraud convictions of petitioners Felis and Carpenter are dependent on the conviction of petitioner Winans, *amici*'s legal analysis will focus on petitioner Winans' conduct.

[3] The agreement was based solely on the perceived value of prepublication access to the Heard column. Pet. App. 6a-7a.

[4] Petitioner Carpenter was not directly involved in the arrangement described. However, Winans made several small pre-

securities on the basis of information derived from the Heard column from October 1983 until March 1984, when Winans and Carpenter, in response to an investigation by the Securities Exchange Commission ("SEC"), voluntarily went to the SEC and testified concerning their activities. Pet. App. 7a.

The courts below found that Winans' trading in securities on the basis of his knowledge of the content and publication date of upcoming Heard columns violated the *Journal*'s internal conflict of interest rules. Specifically, the *Journal*'s conflict of interest rules provided that knowledge of forthcoming articles was "deemed" to be the "property" of the *Journal*. The *Journal*'s internal conflict of interest rules also prohibited employees from trading in securities if they knew that an article about the securities was forthcoming in the *Journal*. Winans believed (correctly) that disclosure of his agreement with Brandt and Felis would result in his dismissal from the *Journal*. Winans testified, however, that he did not believe that he was acting illegally. Pet. 7-8.

Following a bench trial, the district court held that petitioners Winans and Felis had entered into a conspiracy to violate the securities laws and that all three petitioners [5]—Winans, Felis and Carpenters—had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Pet. App. 3a-4a.[6]

The Second Circuit affirmed the securities law convictions under the government's theory that the petitioners had violated Section 10(b) and Rule 10b-5 by trad-

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publication trades in stocks discussed in the Heard column through a brokerage account he opened in Carpenter's name. The counts upon which Carpenter was convicted involved these unrelated securities trades. Pet. App. 38a-39a.

[5] Brandt had pleaded guilty in a separate action; he was the government's main witness at trial.

[6] Petitioners were also convicted on several counts of mail and wire fraud. *See* p. 18 n.17, *supra*.

ing on information that they had "misappropriated" from the *Journal* under the terms of the *Journal*'s conflict of interest rules. The court rejected the suggestion of *amici curiae* that such a broad theory of Rule 10b-5 liability would unnecessarily interfere with the editorial process of the print and broadcast media, thereby raising a potential First Amendment issue. The court stated that any restrictions on First Amendment protected activities "stem from the *Wall Street Journal* . . . company rules, not from any action by the government." Pet. App. 22a.

Judge Miner dissented. Pet. App. 27a-29a. He argued that the "misappropriation" theory, on which the majority relied, previously had been "applied only in those cases involving the taking and use of non-public, confidential, *securities-related information* by those who obtain that information *through special relationships* with their sources of knowledge." *Id.* 27a-28a (emphasis added). In this case, by contrast, "[n]o confidential securities information imparted by reason of any special relationship was purloined by these defendants." *Id.* According to Judge Miner, "[t]o say that the 'publication schedule' of the Wall Street Journal was the non-public, confidential information stolen by defendants is to extend the sweep of section 10(b) and rule 10b-5 beyond all reasonable bounds." *Id.* In essence, the theory adopted by the majority enlarged the "proscription of fraudulent and deceptive practices in connection with the purchase and sale of securities" under Rule 10b-5 into something Congress never intended—a means "to protect the reputation, or enforce the ethical standards, of a financial newspaper." *Id.* 29a.

In a separate SEC enforcement proceeding, petitioners entered into consent decrees pursuant to which they disgorged their profits from these securities trades, without admitting or denying the alleged securities law violations. 17 Sec. Reg. & L. Rep. (BNA) No. 42, at 1884 (Oct. 25, 1985).

SUMMARY OF ARGUMENT

In this criminal prosecution, the Second Circuit has adopted, for the first time, a major expansion of the prohibitions of Section 10(b) of the Securities Exchange Act. The Second Circuit has imposed the obligation to "disclose or refrain" from trading under Section 10(b) and Rule 10b-5 on a complete market outsider—a person with no "inside" information and no fiduciary obligation to any of the companies whose securities were traded. The convictions in this case were based not on a violation of any duty related to the securities markets, but rather on a violation of Petitioner Winans' duty to his employer, the *Wall Street Journal*, under the *Journal*'s code of ethics.

In affirming the convictions, the court below ignored the basic predicate of a Rule 10b-5 violation—that liability under the "disclose or refrain" doctrine must be based on the misuse of confidential information by one who has a clear *fiduciary obligation to the corporation whose shares are traded.* This premise of Rule 10b-5 liability, which has been consistently affirmed since the seminal *Cady, Roberts* decision of the SEC, is supported by the basic purpose of Section 10(b), to protect market participants and thereby promote confidence in the securities markets.

The imposition of Rule 10b-5 liability in this case also improperly disregarded the teaching of this Court's decisions in *Chiarella* v. *United States*, 445 U.S. 222 (1980), and *Dirks* v. *SEC*, 463 U.S. 646 (1983). Both *Chiarella* and *Dirks* make clear that Section 10(b) is limited to correcting only those informational imbalances which result from a breach of fiduciary duty to a market participant.

The Second Circuit's unprecedented expansion of the disclose or refrain obligation is particularly troublesome because of the potential First Amendment issues raised by the application of Rule 10b-5 to journalistic codes of ethics. The vagueness and uncertainty of the Second Cir-

cuit's disclose or refrain obligation is exacerbated by the potential arbitrariness of the SEC's litigation strategy. This Court can fairly construe Section 10(b) to avoid constitutional problems, and should do so. *NLRB* v. *Catholic Bishop of Chicago*, 440 U.S. 490, 507 (1979).

ARGUMENT

As the Second Circuit recognized, the conviction in this case is based on a novel expansion of the misappropriation theory in which petitioners' convictions under the securities laws rest *solely* on a violation of Winans' ethical duty to his employer, the *Journal*. Thus, the *Journal*'s internal operating rules, which are designed to protect the *Journal*'s reputation,[7] have become the basis for a criminal violation of the securities laws. In the absence of the *Journal*'s conflict rules, petitioners would not be criminally liable under Section 10(b). Put another way, at other financial publications which do not have similar conflicts rules, reporters may engage in precisely the same conduct as Winans without fear of prosecution under the securities laws. This striking anomaly—and others like it[8]—show the government's jerry-built theory is far removed from anything contemplated by Congress. Congress did not intend criminal liability to be predicated on private codes of conduct of non-market participants.

Althought *amici* do not condone petitioner Winans' conduct, *amici* submit that the government's theory of this case, as adopted by the Second Circuit, is clearly beyond

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[7] The court stated that the "interest" protected under its theory was the reputational interest of the *Journal*, as reflected in its conflicts policy: "[the *Journal*'s] employees should be and are barred from destroying their employer's reputation by misappropriating their employer's informational property." Pet. App. 20a-21a.

[8] For example the "sources" who provided the "non-inside" information to Winans were free to trade on their knowledge of the upcoming publication of that material. Moreover, as the court of appeals recognized, the *Journal* itself would be free to trade on the content of the Heard column. Pet. App. 20a-21a.

the scope of Section 10(b). In any event, the government's theory raises First Amendment questions, which can be readily avoided if Section 10(b) is fairly construed to invalidate this prosecution. Accordingly, the judgment below must be reversed.

I. WINANS WAS A PURE "OUTSIDER" AND HIS BREACH OF THE ETHICAL DUTIES HE ALLEGEDLY OWED TO THE *WALL STREET JOURNAL* WAS NOT A VIOLATION OF SECTION 10(b) OF THE SECURITIES ACT.

A. The Duty To Disclose Or Refrain From Trading Does Not Apply To A Market Outsider With No Inside Information Of The Corporation Whose Shares Are Being Traded.

To understand *amici*'s concerns, it is important to recognize how far removed the theory of this case is from the core purpose of Rule 10b-5's traditional prohibitions. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), prohibits the use "in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" a Securities Exchange Commission rule. The Commission's Rule 10b-5, in turn, proscribes any act that "would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. 240.10b-5 (1984).

There is little legislative history to aid in the construction of this admittedly broad statutory and regulatory language. See *Santa Fe Industries* v. *Green*, 430 U.S. 462, 473 n.13 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 202 (1976). However, the general purpose of the Act is clear: Section 10(b) was designed to protect market participants from fraudulent practices and thereby promote confidence in the securities markets. See H.R. 1383, 73rd Cong., 2d Sess. (1934); S. Rep. No. 792, 73rd Cong., 2d Sess (1934); *Ernst & Ernst*, 425 U.S. at

194-95. Thus, the core purpose of the Act is to prohibit "fraud"—misleading statements of material fact in connection with the purchase or sale of securities. See, *e.g.*, *Marx* v. *Computer Sciences Corp.*, 507 F.2d 485 (9th Cir. 1974).

It is now well established that, in addition to misstatements of fact, silence when there is a duty to speak may also constitute "fraud" with the meaning of Rule 10b-5. The Securities Exchange Commission and the courts have long held that corporate insiders (*i.e.*, officers, directors, and majority shareholders) who are privy to corporate secrets may not trade in securities on the basis of "inside" information without prior disclosure of that information. See, *e.g.*, *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); see also *Chiarella* v. *United States*, 445 U.S. at 230. The Commission has, therefore, developed the rule that insiders must: (a) disclose the corporate secrets to the other party to the transaction, so that the other party can make a fully informed decision whether or not to trade; or (b) refrain completely from trading in the affected securities. See *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). This duty imposed on corporate insiders arises from the insider's state law fiduciary obligation to the corporation and its shareholders. *Cady, Roberts & Co.*, 40 S.E.C. at 911-912. See *Chiarella*, 445 U.S. at 227-30; *Dirks* v. *S.E.C.*, 463 U.S. 646, 660 (1983).

The Commission has expanded the insider trading doctrine of Rule 10b-5 to proscribe trading on "inside" information by individuals who are not themselves insiders but who knowingly and wrongfully obtain confidential information from an insider. See, *e.g.*, *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 237 (2d Cir. 1974); *Ross* v. *Licht*, 263 F. Supp. 395, 410

(S.D.N.Y. 1967). These tippees "assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*." *Dirks*, 463 U.S. at 660; see *In re Investors Management Co.*, 44 S.E.C. 633, 650 (1971). Thus, the tippee's duty to disclose or refrain from the trading derives from the inside "tipper's" fiduciary duty to the corporation and its shareholders. *Dirks*, 463 U.S. at 66 n.20.[9]

The Second Circuit has allowed the further expansion of the "disclose or refrain" rule to prohibit trading by "extended insiders," *i.e.*, individuals such as financial printers,[10] investment bank employees[11] or law firm employees,[12] who in the normal course of their employment obtain inside information about confidential corporate affairs. This expansion of the insider trading prohibitions is based on the theory that such "extended insiders" "have entered into a special confidential relationship in

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[9] Commissioner Smith explained the basis for "tippee" liability in *Investors Management Co.*:

> [t]ippee responsibility must be related back to insider responsibility by a necessary finding that the tippee knew the information was given to him in breach of a duty by a person having a special relationship to the issuer not to disclose the information. . . ."

44 S.E.C. 633, 651 (1971) (concurring in result). Tippee liability has also been justified by the theory that a third person who knowingly receives confidential information from a fiduciary in violation of the fiduciary's obligation to his beneficiary holds such information in constructive trust for the beneficiary. *Dirks*, 463 U.S. at 660, n.20 *quoting* 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961).

[10] *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985).

[11] *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983).

[12] *SEC* v. *Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984).

the conduct of the business of the [corporation] and are given access to information solely for corporate purposes." *Dirks*, 463 U.S. at 655 n.14. Use of the confidential information so acquired for private gain, without disclosure, constitutes "misappropriation" of that information in violation of the extended insider's fiduciary duty to the corporation and its shareholders.

While the duty to disclose or refrain under Rule 10b-5 has expanded over the years, it has, until this case, remained anchored to its central premise—that liability for "insider trading" results from the misuse of confidential corporate information by one who has a clear fiduciary obligation to the corporation whose shares are traded.[13] That premise has been the basis of the disclose or refrain doctrine since the seminal *Cady, Roberts* decision, in which the "Commission emphasized that the duty [to disclose or refrain] arose from (i) the existence of a relationship affording access to inside information . . . and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." *Chiarella*, 445 U.S. at 227, *citing Cady, Roberts*, at 912 & n.15.

It is because there is a duty to the corporation whose securities are being traded that the fraud is "in connection with" the purchase or sale of securities within meaning of the statute. Without that limitation, the statute

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[13] In the case of the corporate insider, the basis for the fiduciary duty is based on the common law duty to avoid self-dealing. *See* Cady, Roberts, 40 S.E.C. at 911 & n.13. The tippee "assumes a fiduciary duty to the shareholders of a corporation . . . only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach." *Dirks*, 463 U.S. at 660. An "extended insider," such as an attorney or investment banker, acquires a fiduciary duty to the shareholders on the basis of his "special confidential relationship" to the corporation and the corporation's expectation, whether or not expressed, that he will keep the non-public information confidential. *Id.* at 655 n.14.

could be extended to situations where a wrongdoer engages in fraud to obtain money and then uses the money to purchase securities. While that conduct is surely wrong, Congress clearly did not intend to authorize the SEC to investigate and regulate any ordinary fraud simply because the proceeds may have been converted into securities.[14]

The government's theory in this case is not materially different from this hypothetical. Instead of taking someone else's money and trading in the market, Winans took the *Wall Street Journal*'s publication schedule for the Heard column and traded in the market. It must be stressed that *in this case*, the government alleged and proved harm only to the *Journal* and not to any buyer or seller of stock. Pet. App. 18a, 20a-21a.

The fundamental flaw with this application of the misappropriation theory is the complete absence of any link between Winans and the corporations whose securities were traded. Winans is a complete market outsider. Under the long-established premise of Rule 10b-5 liability, Winans simply had no duty to disclose because he had *no fiduciary obligation*, through employment or other relationship, with the corporations whose shares were traded.

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[14] Congress could determine, for policy reasons, to broaden the scope of Section 10(b)'s "disclose or refrain" obligation to further other legitimate purposes, such as the protection of the *Journal*'s reputation. However, the government has not, and cannot, point to any legislative history suggesting that Congress intended that the current securities laws would be used to "protect" private reputations. It is also clear that Congress never intended Section 10(b) to establish a "general duty between all participants in market transactions to forgo actions based on material nonpublic information." *Chiarella*, 445 U.S. at 233. In fact, the securities laws *allow* certain forms of trading on nonpublic market sensitive information. *See, e.g.*, 15 U.S.C. § 78m(d)(1) (allowing tender offer or to purchase up to 5% of target stock prior to disclosure of acquisition).

Moreover, unless the element of fiduciary obligation is linked to a market participant, the *only* limiting principle of the "disclose or refrain" doctrine will be eliminated. If the Court does not draw the line here, the "significant distinction" between legal obligations and ethical ideals will be erased,[15] and the federal government will be free to seek criminal sanctions for any trading in securities relating in any way to violations of private standards of conduct and ethics.

B. The Government's Misappropriation Theory As Applied In This Case Clearly Conflicts With The Prior Decisions Of This Court.

In applying Rule 10b-5 to a complete market outsider who had no access to any "inside" information and who owed no fiduciary duty to any companies whose securities he traded, the Second Circuit not only could find no support in the purpose and history of Section 10(b) but it also improperly disregarded this Court's decision in *Chiarella* v. *United States*, 445 U.S. 222 (1980), and *Dirks* v. *SEC*, 463 U.S. 646 (1983).

1. In *Chiarella* v. *United States*, this Court reversed the conviction under Section 10(b) of a financial printer who had traded on the basis of his advance knowledge of takeover bids. The Court held that liability for failure to disclose such information prior to trading in securities can only be imposed where there is a "duty to disclose arising from a relationship of trust and confidence between parties to a transaction." *Chiarella*, 445 U.S. at 230. The conviction was reversed because the "Court of Appeals, like the trial court, failed to identify a relationship between [Chiarella] and the sellers that could give rise to a duty." *Id.* at 231-236.[16] Instead, in

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[15] *See Dirks*, 463 U.S. at 661 n.21 (*quoting* SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963)).

[16] The Court left open the question whether Chiarella could have been convicted on the theory that his misappropriation of the

Chiarella, the court of appeals had relied on a "parity of information" theory under which persons like Chiarella, who have access to confidential information, may be restrained from trading, absent disclosure, to avoid "unfair advantage over less informed buyers and sellers." *Id.* at 232.

This Court found that reasoning defective in two respects. First, "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)." *Id.*, (*citing Santa Fe Industries* v. *Green*, 430 U.S. 462, 474-77 (1977)). Second, the "element required to make silence fraudulent—a duty to disclose—[was] absent in [Chiarella's] case." *Id.* With respect to Chiarella's obligation to the shareholders from whom he purchased the securities at issue the Court noted:

> He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions.

Id. at 232-33.

Finally, the Court noted that any judicial adoption of a broad duty of disclosure that departed radically from the traditional basis of such duties in fiduciary relationships "should not be undertaken absent some explicit evidence of congressional intent." *Id.* at 233. The Court left open the issue of whether a broader reading of obligations under Section 10(b) might raise questions of whether potential defendants had been given fair notice of the criminality of their acts. *Id.* at 235 n.20 (*citing*

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information on which he based his trading breached a duty to his employer, the printing company, which, in turn, owed a duty to the acquiring company in the takeover bid. Even assuming that this version of "misappropriation" theory were adopted under the rubric of "extended insider," the *Journal*—unlike the printing company in *Chiarella*—owed no duty to the companies whose stock was traded by petitioners.

Grayned v. *City of Rockford*, 408 U.S. 104, 108-109 (1972)).

2. In *Dirks*, this Court reiterated its careful interpretation of the Rule 10b-5 duty to "disclose or refrain." In that case, Dirks, a broker-dealer, received nonpublic information that the assets of a corporation, Equity Funding, were "vastly overstated." Based on this information Dirks recommended to some of his clients that they sell their Equity Funding shares. It was undisputed that Dirks had access to information—from the officers and employees of the corporation—that was not generally available to the market. It was also undisputed that Dirks' clients benefited from trading on that non-public information. On the basis of these facts, the SEC censured Dirks for aiding and abetting a violation of Rule 10b-5. This Court reversed, holding that Dirks "had no duty to abstain from use of the inside information that he obtained." *Dirks* 463 U.S. at 667.

Although Dirks received confidential information from Equity Funding insiders, "[i]t is clear that . . . [no] Equity Funding employees violated their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks." *Id.* at 666 (footnote omitted). "In the absence of a breach of duty to shareholder by the insiders, there was no derivative breach by Dirks." *Id.* at 667.

In holding that Dirks, as a stranger to Equity Funding and its shareholders, could not be held liable directly for breaching Rule 10b-5, this Court ruled that "there can be no duty to disclose where the person who has traded on inside information 'was not [the corporation's] agent, . . . was not a fiduciary [of the corporation, and] was not a person in whom the sellers [of the securities] had placed their trust and confidence.'" *Id.* at 654, *quoting Chiarella*, 445 U.S. at 232.

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Thus, both the history of Rule 10b-5 and the holdings of this Court require that, in cases of failure to disclose information, the scope of Rule 10b-5 should be limited to situations where there is a breach of a *fiduciary duty* to the corporation whose securities have been traded or to its shareholders.[17] Certainly, the securities laws should only correct those informational imbalances caused by breaches of some duty owed to a *market participant*. Without such a nexus, the reach of Rule 10b-5 is virtually limitless and can be used to criminalize virtually any unethical practice which has some relationship to the securities markets. Indeed, the government has offered no limiting principle for its theory other than its own good faith.

It is neither necessary nor appropriate for the SEC to attempt to ferret out all breaches of duty to all employers simply because an employee's misconduct bears some connection to a securities transaction. Such matters can and should be handled by self-policing mechanisms within the industry. Newspapers ordinarily can uncover ethical violations and take appropriate action without the intervention of the SEC.[18] The availability of private and state law alternatives to the federal securities laws argues forcefully for limiting the scope of Rule

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[17] *Amici* will not address the various issues under the mail and wire fraud statutes raised by petitioners in this case. However, to the extent that the "fraud" claim is based solely on Winans' "failure to disclose to his employer (the *Wall Street Journal*) that he had breached the *Journal's* private rules of confidentiality . . ." *see* Pet. 18, *amici* submit that a holding which permits the government to enforce an obligation to disclose or refrain from trading under the mail and wire fraud statutes affects the First Amendment rights of *amici* just as much as enforcement of similar requirements under the securities laws. *See* pp. 20-25, *infra*.

[18] If the Commission believes that a *federal* judicial remedy is necessary in the circumstances of this case, it should seek to have such a remedy created by Congress. But it should not attempt to have such a remedy "supplied by judicial extension of § 10(b) and Rule 10b-5 to 'cover the corporate universe.'" *Santa Fe Industries* v. *Green*, 430 U.S. 462, 480 (1977) (footnote omitted).

10b-5, especially where the Congress has not spoken. *Santa Fe Industries* v. *Green*, 430 U.S. 462, 478-479 (1977) (rejecting an interpretation of Rule 10b-5 that would "bring within the Rule a wide variety of corporate conduct traditionally left to state regulation"); *Piper* v. *Chris-Craft Industries*, 430 U.S. 1, 40-41 (1977). See also Pet. App. 10a n.5 & 21a n.11.

In sum, this Court should hold that the government's theory of criminal liability under Rule 10b-5 is not authorized by the Congress and is in conflict with the decisions of this Court.

II. THE COURT SHOULD CONSTRUE SECTION 10(b) TO AVOID SUBSTANTIAL CONSTITUTIONAL QUESTIONS.

The government's unprecedented attempt in this case to expand the "disclose or refrain" obligations is particularly troublesome because of its potential effect on the editorial processes of the print and broadcast media protected by the First Amendment. Two factors combine to create First Amendment problems: the vagueness and uncertainty of the application of Rule 10b-5 to journalistic codes of ethics and the potential arbitrariness of the SEC's litigation strategy, which this Court has commented upon in the past. Together, these factors threaten infringement of First Amendment rights. Accordingly, this Court should narrowly construe Section 10(b) to avoid such constitutional problems. *NLRB* v. *Catholic Bishop of Chicago*, 440 U.S. 490, 507 (1979). Because the government's theory is so far from the core of Section 10(b) and so contrary to the purpose of the nondisclosure rules of Rule 10b-5, such a construction is surely a fair one.

Under the government's theory of the case, the government is now authorized to regulate aspects of the reporter-editor relationship by enforcing vague ethical obligations of a reporter to his employer if their breach may affect

securities trading—obligations which will vary with the particular code of ethics adopted by particular media organizations. Such codes of ethics are not written like criminal statutes, and their violations are not intended to result in criminal sanctions. They were not written to create complex issues of criminal liability under the securities laws for publishers, editors and reporters.

Amici's concern with the potential scope of the government's theory of the Rule 10b-5 liability can be readily illustrated by a realistic hypothetical. A reporter obtains non-public information, which does not derive from "inside" sources, that XYZ corporation has made a big oil find. He plans to use that "non-inside" information in an article for his paper. The reporter needs, however, additional sources to confirm the story. Although the newspaper has a policy against disclosing information which might be used for stock market trading, the reporter contacts an expert geologist, who has not heard about the oil find, but knows how to obtain confirmation. The reporter knows from past experience that the expert may seek to trade on the basis of such information. The expert obtains confirmation of the find and then buys XYZ's stock, knowing that the price will rise sharply after the story is published. The expert then calls back the reporter, reports his findings and tells him that he purchased stock in XYZ company. Under the government's theory as applied by the courts below, the reporter may be liable under the securities laws because he has used the newspaper's information, which when published will affect the market, to obtain a benefit (confirmation of an important story) in arguable breach of the employer's ethical code.[19] In addition, the editor may be liable for aiding and abetting the breach if he publishes the story. In these circumstances,

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[19] The benefit derived by the tipping party need not be an immediate financial gain in order to create liability under Rule 10b-5. *See Dirks*, 463 U.S. at 663-664.

neither the reporter nor the editor will know how to proceed. Of course, without the use of the expert's confirming statements, the reporter might not even have a publishable story.

1. This Court has previously recognized that the editorial process, which includes the relationship and communications between reporters and editors, is constitutionally protected from "casual inquiry" by the federal government. See *Herbert* v. *Lando*, 441 U.S. 153, 174 (1979); *Richmond Newspapers, Inc.* v. *Virginia*, 448 U.S. 555, 576 (1980) (plurality opinion); *First National Bank of Boston* v. *Bellotti*, 435 U.S. 765 (1978). The government's effort, sanctioned by the Second Circuit, to impose an uncertain "disclose or refrain" obligation on reporters based on violations of journalistic codes of ethics directly interferes with this process by dictating without specificity that reporters must make some disclosures to their editors.

The disclosures required by the government's theory also will affect editors making the decision whether an article should be published because publication is a critical element of the securities fraud. Under the government's theory, if the reporter discloses prior trading to his editor, the editor's decision to proceed with publication might be held to constitute aiding and abetting the violation of the securities law. See *IIT* v. *Cornfeld*, 619 F.2d 909 (2d Cir. 1980). Thus, the application of the "disclose or refrain" rule in the media context implicates a central concern of the First Amendment—the prohibition against restraints on publication. See, *e.g.*, *Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. 241, 254-255 (1974); *CBS* v. *Democratic National Comm.*, 412 U.S. 94, 117 (1973) (plurality opinion); *Near* v. *Minnesota*, 283 U.S. 697 (1931).

Moreover, because the disclosure requirement is derived from an inherently vague anti-fraud rule *and* from inherently vague codes of journalistic ethics (not promul-

gated for the purpose of defining crimes), there is a potential that *amici* and their members will be chilled in their communications and decisions as to what to write or publish due to the threat of civil or criminal sanctions.[20] By authorizing the federal government to push Rule 10b-5 beyond the board rooms and into the news rooms, the court below has opened a door for potential governmental abuse. The financial press is now subject to routine governmental scrutiny for possible breaches of the newspapers' work rules that may have affected some securities transaction to benefit a reporter in some way. Doubtless sensitive to the obvious problem for the press created by the unwarranted extension of Rule 10b-5, the SEC has publicly eschewed any intent to overreach in its enforcement efforts against the print and broadcast media.[21] But this Court has recognized expressly that reliance on the "reasonableness of the SEC's litigation strategy . . . . [is] hazardous" at best. *Dirks* v. *SEC*, 463 U.S. at 664 n.24. The very existence of this authority, which is inherently susceptible to abuse for political reasons, coupled with this Court's own doubts about the

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[20] As in *Dirks*, the rule developed in this case is "inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements." *Dirks*, 463 U.S. at 658 n.17. Thus, even absent First Amendment concerns, the Second Circuit's holding that "certain undefined activities" may be prohibited by Section 10(b)—depending on internal codes of ethics—"raise[s] questions whether either criminal or civil defendants would be given fair notice that they have engaged in illegal activity." *Chiarella*, 445 U.S. at 235 n.20. The fact that the prosecution in this case does implicate First Amendment concerns requires that the line between ethical requirements and criminal violations be drawn with even greater clarity.

[21] In a speech given soon after this case began, the Enforcement Director of the SEC stated that the Commission "does not intend to inject itself into the editorial judgments reporters must make." BNA, *Daily Report for Executives* p. A-5 (Oct. 24, 1984). But it is unquestionably true that the very presence of Rule 10b-5 can affect editorial judgments by injecting a new concern into basic editorial decisions.

future reasonableness of the SEC's litigation practices, threatens infringement of First Amendment rights.

2. If the Court finds that the theory of Rule 10b-5 liability adopted by the court below does constitute an infringement of First Amendment rights, then this prosecution can only be upheld if it is necessary to serve a government interest of the highest order. See, *e.g.*, *NAACP* v. *Button*, 371 U.S. 415, 438 (1963); *Smith* v. *Daily Mail Publishing Co.*, 443 U.S. 97 (1979). Here, the government has not even attempted to make a showing that there is any substantial government interest to support this intrusion into the editorial process. Nothing in the legislative history suggests *any* Congressional interest in using the securities law to protect the reputation of a financial newspaper when there is no alleged or proven injury to a market participant.

Instead of addressing *amici*'s First Amendment contentions directly, the Second Circuit sidestepped the constitutional issue by arguing that the "restrictions stem from the *Wall Street Journal* . . . rules, not from any action by the government." Pet. App. 22a. This logic is totally specious. There is a vast difference between private enforcement of internal ethical guidelines and federal criminal prosecutions. The government is engaged in the unprecedented practice of using existing internal codes of ethics to "make" criminal cases. Moreover, the government's theory results in irrational outcomes, *e.g.*, a reporter in a news organization without formal ethical rules may engage in conduct identical to Winans' without being subject to prosecution and a publisher may trade with impunity on knowledge about forthcoming stories even though a reporter may face federal criminal charges if he does so. The fact that the government's theory of this case is riddled with irrationality indicates that the government's interest is exceedingly weak and cannot sustain the infringement created by the rule.

3. Even if the Court finds that the prosecution in this case does not present a sufficient threat to First Amendment's interest to trigger the "compelling government interest" standard, there is nevertheless reason to weigh the potential First Amendment interest in the balance in the Court's consideration of the proper scope of Section 10(b). As *amici* have demonstrated, pp. 20-23, *supra*, the vagueness and uncertainty created by the government's theory, coupled with doubts about the reasonableness of the SEC's enforcement policy, provide a basis for serious concern about the impact of the government's theory of Rule 10b-5 liability on *amici* and the print and broadcast media they represent.

It is a well-established principle that the courts will construe statutes to avoid constitutional issues where such a construction is fair and reasonable. See, *e.g.*, *Lowe* v. *SEC*, 472 U.S. 181, 190 & n.24 (1985); *NLRB* v. *Catholic Bishop of Chicago*, 440 U.S. 490, 507 (1979). Here, the construction of Section 10(b) espoused by *amici* clearly is a fair reading of the statute. Indeed, in this case, it is the government's interpretation of the scope of Section 10(b) that is unreasonable and outside the legitimate concerns of the Congress.

Finally, the government's prosecution of this case, which for the first time incorporates violations of journalistic codes of ethics into the federal criminal code, disregards the well-established rule that "ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity." *Rewis* v. *United States*, 401 U.S. 808, 812 (1971), *citing Bell* v. *United States*, 349 U.S. 81, 83 (1955). As noted previously, *amici* are unanimous in this condemnation of Winans' conduct. It is far from clear, however, that a federal criminal prosecution in these circumstances is necessary to protect either the securities markets or financial journalism. In sum, the government's theory, at best, is tenuously linked to the purposes of the securities laws and constitutes a potential threat to the industry it was designed to "protect." Ac-

cordingly, the Court should reject the expansion of Section 10(b) esopused by the government and reaffirm the established basis of Section 10(b) liability as set forth in *Chiarella* and *Dirks*.

* * * * *

Such a construction should have no impact on prosecutions growing out of the recent and wide-spread abuse of genuine "inside" trading on Wall Street. The unprecedented and anomalous prosecution in petitioner Winans case involves a pure "outsider" whom Congress never intended to reach when it enacted Section 10(b). Given the broad scandal regarding genuine "insider" trading which is now sweeping Wall Street, Congress will be taking a serious look at defining, through new statutory language, the circumstances under which non-disclosure of confidential information violates the securities law. Given the broad implications of making non-disclosure by an "outsider" a violation of federal law, it should be a task for the Congress, not for the SEC or a United States Attorney, to determine whether such a rule is necessary or appropriate.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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